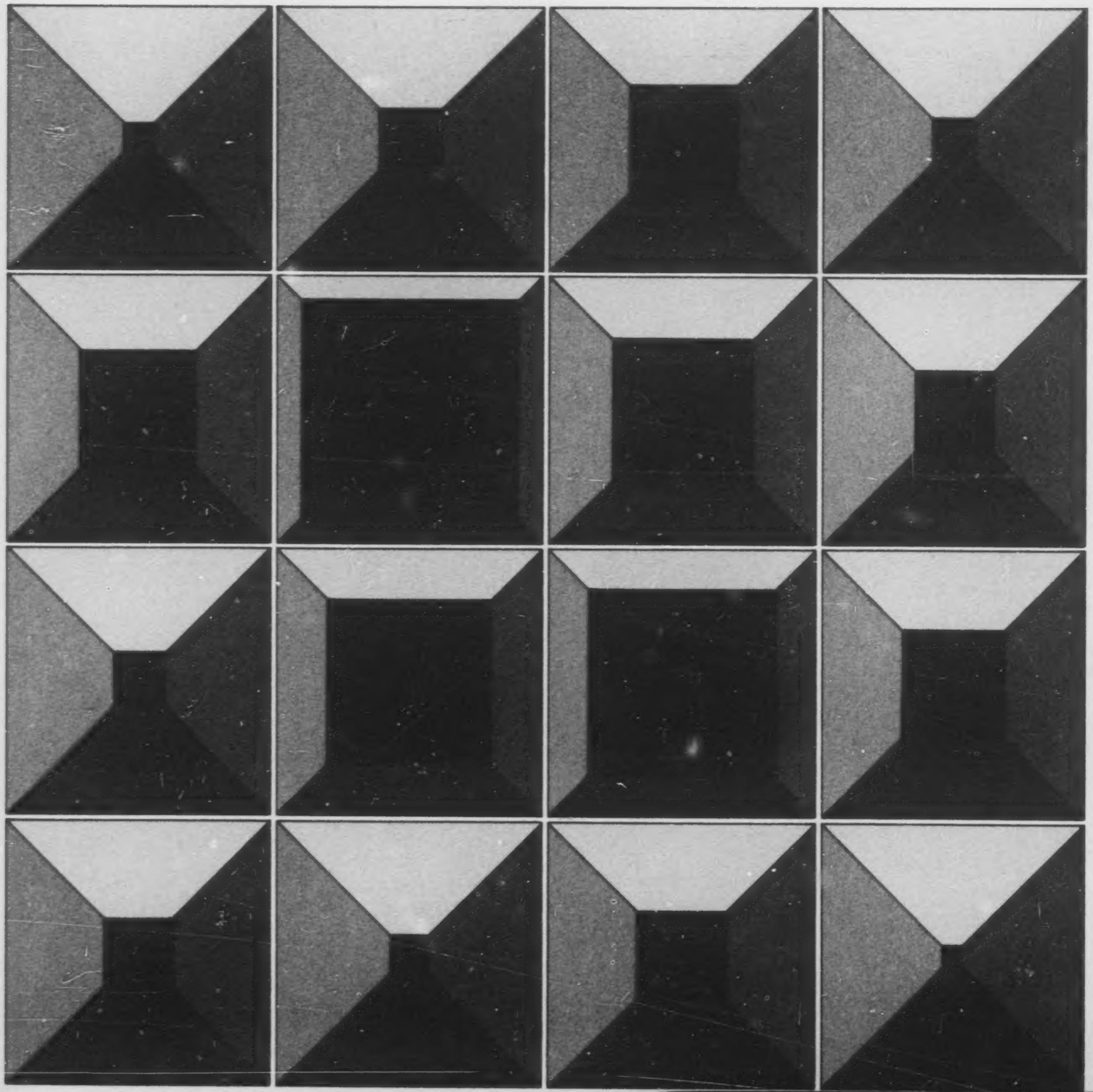
A CBO STUDY

Federal Subsidies for Public Housing: Issues and Options

June 1983

Congress of the United States
Congressional Budget Office



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FEDERAL SUBSIDIES FOR PUBLIC HOUSING: ISSUES AND OPTIONS

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Unless otherwise noted, all years referred to in this report are fiscal years.

Details in the tables may not add to totals because of rounding.

PREFACE

This year the Congress is considering proposals to modify the system for subsidizing public housing operations and modernization. This paper, requested by the House Budget Committee, describes the mechanisms for setting subsidy levels and discusses current concerns about the level and distribution of assistance. It compares options for addressing these concerns, ranging from incremental adjustments to new methods of determining subsidy levels.

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In accordance with CBO's mandate to provide objective and impartial analysis, this paper contains no recommendations.

Alice M. Rivlin
Director

June 1983

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SUMMARY

The public housing program, administered by the Department of Housing and Urban Development (HUD), is the oldest of the direct federal housing assistance programs and one of the largest, aiding 1.2 million households in 1982. Though funded by the federal government, public housing is owned and managed by local public housing authorities (PHAs) and rented to low-income households, which pay no more than 30 percent of their incomes for their housing costs. Because rents are too low to cover costs, the federal government pays a share of ongoing operating expenses, as well as the entire costs of initial construction and subsequent improvements to physically deficient units. Federal expenditures for all these purposes totaled $2.6 billion in 1982--up from $860 million a decade earlier.

Public housing is an important resource in meeting the housing needs of low-income households, contributing 10 percent of the housing occupied by very-low-income households 1/ and as much as 15 percent of the rental housing stock in some cities. Like poor households in general, public housing tenants are far more likely than households renting in the private market to be headed by women and to have above-average numbers of children. About 55 percent of public housing units are occupied by families, most often a single woman with children, and the remaining units are occupied by households with an elderly head, generally a woman living alone. Contrary to many stereotypes, public housing units are, by and large, in reasonably sound condition, though most need some repair. A small subset of units is, however, in very poor condition and would require large expenditures per unit to meet current quality standards.

ISSUES SURROUNDING THE PUBLIC HOUSING PROGRAM

Pending before the Congress are proposals to modify current mechanisms for subsidizing both operations and physical improvements, which

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1. Under statutory definition, low-income households are those with incomes below 80 percent of the area median, and very-low-income households are those with incomes below 50 percent. Up to 10 percent of the units provided before 1982 and 5 percent of those provided since then may be occupied by households with incomes between 50 and 80 percent of the area median; the rest are reserved for very-low-income households.

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would address recent concerns about the way in which funds are allocated and the incentives that exist for efficient management. Funding decisions, however, have wider implications for the public housing program.

In particular, the level of funding and the way in which it is allocated affect the number of units that can be maintained in the public housing stock and the standards that these units meet, both in the short term and in the long run. At relatively low levels of funding, it may not be possible to maintain all units--particularly badly deteriorated ones--at given standards. Higher funding will allow either the repair and maintenance of larger numbers of units or increased quality standards for fewer units. The levels of funding will also determine costs of maintaining standards over time. Relatively high funding now may reduce future costs if used for improvements that reduce operating costs or that prevent later, more costly, maintenance needs. Low levels may save current dollars at the expense of increased future costs resulting from deferred maintenance.

The manner in which subsidies are provided will also affect the quality of public housing, as well as the costs. For example, the Congress could increase flexibility by providing a single subsidy to PHAs for operations and physical improvements, instead of funding these activities separately. This change could result in units that met higher standards or cost less, assuming that managers were enabled to operate more efficiently--for example, by coordinating maintenance and modernization activities. On the other hand, if managers found it difficult to operate without federal guidelines, the result might be lower standards or higher costs. Standards could also vary more over time if, for example, PHAs increased spending on current operations and were unable later to finance needed repairs.

CURRENT MECHANISMS FOR SUBSIDIZING PUBLIC HOUSING

Operating assistance for public housing is provided through the Performance Funding System (PFS). The modernization of deficient units is financed through the Comprehensive Improvement Assistance Program (CIAP).

Operating Subsidies

Federal operating subsidies cover the difference between the income received by PHAs--primarily from rent collections--and what are considered to be reasonable measures of operating costs. Allowable operating costs for all expenses except utilities were initially established on the basis of the past costs of a group of PHAs considered to be managed well; costs have been updated each year to reflect increases in prices and changes in each PHA's operating circumstances. Allowable utility costs are based on average consumption levels over the past three years and on current utility rates. Operating subsidies under this system averaged \$95 per unit per month in 1982, or \$1.3 billion in total. If the system remained unchanged, subsidies under the Performance Funding System would average \$120 per unit per month by 1988, or a total of \$1.6 billion (see Summary Table 1).

Modernization Subsidies

Through the modernization program, HUD allocates funds on a discretionary basis to PHAs to make comprehensive improvements in selected housing projects. The types of activities undertaken generally involve increasing the energy efficiency of public housing, replacing capital items such as roofs or heating systems, improving the physical condition of projects by repairing exterior and interior walls, and updating kitchen and bath facilities. Between 1980 and 1981, the Congress funded \$3.2 billion in improvements, requiring \$6.1 billion in budget authority to cover the 20-year debt-service costs. 2/ If the same real level of improvements continued to be funded through 1988 as was provided in 1983, budget authority requirements would average \$3 billion per year and \$15 billion over the period--enough to finance a total of \$7.4 billion in improvements.

Criticisms of the Current System

Though they were introduced as reforms of earlier subsidy systems, these mechanisms have recently aroused concern about the way in which they allocate funds and the effects they have on public housing management. Specific criticisms of the Performance Funding System have focused on the way in which subsidies were initially set and have increased over time. The limits imposed on the operating costs of all PHAs--to levels similar to those of well-run PHAs--may have underestimated the legitimate operating expenses of some PHAs, particularly large urban ones. Further, adjustments in allowable expense levels, meant to compensate PHAs for changes in prices and operating conditions, do not necessarily reflect the actual change in their costs. Some adjustments are complex to calculate,

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2. Capital expenditures for public housing, whether for initial construction or for modernization, are financed through long-term bonds sold by public housing authorities. The federal government pledges to pay the full principal and interest payments on these bonds, however, which for modernization extend 20 years.

SUMMARY TABLE 1. PROJECTED FUNDING LEVELS FOR CURRENT PUBLIC HOUSING SUBSIDY PROGRAMS, 1984-1988

	1984	1985	1986	1987	1988	1984-1988
	(dollars per unit per month)					
Performance Funding System a/	106	111	114	117	120	568
Comprehensive Improvement Assistance Program b/	213	220	230	241	252	1,156
Total	319	331	344	358	372	1,724
	(millions of dollars)					
Performance Funding System a/	1,370	1,470	1,500	1,530	1,550	7,420
Comprehensive Improvement Assistance Program b/	2,740	2,900	3,020	3,140	3,260	15,060
Total	4,110	4,370	4,520	4,670	4,810	22,480

SOURCE: Congressional Budget Office.

a. This excludes subsidies provided for U.S. territories, which are determined outside the Performance Funding System.

b. This is the budget authority required to fund the same real level of improvements as was provided in 1983. These funds would be spent over 20 years to make debt-service payments on the bonds issued to finance modernization.

particularly in view of the relatively small effects they have. And in some areas it should be possible to increase the incentives for efficient management of public housing.

A central criticism of the modernization procedures is that, because operating funds are separated from improvement funds, PHAs have an incentive to postpone routine maintenance when possible until modernization funds are available, thereby potentially increasing the total cost of achieving the intended quality standard. Further, because funding is available on a project basis, some projects receive extensive improvements while others in similar condition do not.

OPTIONS FOR MODIFYING THE SUBSIDY MECHANISMS

Concern about the efficiency and equity of the mechanisms for subsidizing public housing has led to several proposals for modifying them. The general approaches include:

- Incremental adjustments to the funding of operations;
- An alternative approach to the funding of modernization; and
- Comprehensive change in the system of setting subsidies for both operations and modernization.

Both the House and Senate Banking Committees have reported legislation, H.R. 1 and S. 1338, that would adjust the funding of operations. The Senate Committee would, in addition, alter the modernization system to provide formula-based subsidies for improvements. The Administration has also proposed formula-based modernization subsidies as one part of a comprehensive change.

Incremental Changes in the Performance Funding System

Incremental changes could address the specific shortcomings of the PFS without a disruptive shift to a new subsidy mechanism, but would not address the basic concern that past costs are not the appropriate basis for future subsidies.

Alter Allowable Expense Levels. One modification of the PFS would be to adjust the allowable operating costs of those PHAs that are believed to be undercompensated for the actual costs of operating efficiently, as H.R. 1 would direct. Because the data on which initial allowable expenses were based are no longer available, some alternative criterion would be needed to single out PHAs with subsidies deemed to be too high or too low. The costs of such a change would depend in part on the criterion or proxy selected, which would determine the amount by which subsidies were changed. Alternatively, an appeals process could be established for PHAs to request review of their subsidy levels, and HUD officials could determine whether and how much adjustment was required. An increase in subsidies would increase the number or quality of housing units that could be maintained.

Change Annual Adjustments to Allowable Expense Levels. Each year, nonutility allowable expense levels are adjusted by projected rates of inflation. A year-end retrospective adjustment--like that for utility costs--would ensure that subsidy levels reflected actual, rather than projected, inflation. Such an adjustment is called for in both H.R. 1 and S. 1338. It would probably have only a small effect on total federal costs over several years, but would increase somewhat the complexity of subsidy calculations.

Increase Management Incentives. Other adjustments to the PFS could increase incentives for efficient management. For example, the current practice of subsidizing vacant units could be modified or eliminated, as proposed in S. 1338. Finally, HUD oversight of PHA operations could be reduced for well-managed PHAs and increased for those experiencing difficulties, as considered by the Senate Banking Committee.

Alternatives for Funding Modernization

Options for altering the present discretionary modernization program have focused on providing formula-based funds to PHAs, which would then be responsible for both short- and long-term maintenance of the public housing stock. This approach, included in both S. 1338 and the Administration's proposal, assumes that, if given responsibility and limited funds, PHAs would develop cost-effective maintenance strategies. On the other hand, the quality of the public housing stock could erode if PHAs were unable to plan effectively or if funding intended for modernization and capital repairs was used instead for current operating costs.

Under the Administration's proposal, PHAs would be responsible for all capital improvements and repairs and would receive additional funding equal to 20 percent of annual nonutility operating costs, which would total $1.9 billion between 1984 and 1988 (see Summary Table 2). Under S. 1338, PHAs would have responsibility for all but major capital items, which would continue to be funded on a discretionary basis by HUD. 3/ Formula funding

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3. Under S. 1338, HUD would determine the major capital items to be funded on a discretionary basis, with recommendations from a commission of PHA managers, tenants, and local officials.

SUMMARY TABLE 2. PROJECTED SUBSIDIES UNDER ALTERNATIVE MEANS OF FINANCING IMPROVEMENTS TO PUBLIC HOUSING, 1984-1988
(In millions of dollars)

	1984	1985	1986	1987	1988	1984-1988
Improvements Allowance Set at 20 Percent of Nonutility Operating Costs	340	360	380	400	420	1,900
Improvements Allowance Set at 15 Percent of Nonutility Operating Costs	250	280	290	300	310	1,430
Capital Reserve Fund a/	160	170	180	180	190	880
Total	410	450	470	480	500	2,310

SOURCE: Congressional Budget Office.

a. This estimate is based on actual spending for capital items between 1975 and 1979. Future levels might be higher or lower than past levels. Estimates would also be higher if capital improvements were financed through long-term bonds, as is currently the case.

would be set at 15 percent of nonutility operating costs, or an estimated $1.4 billion between 1984 and 1988, while funding for capital items would depend on annual appropriations.

Under both proposals, additional interim funding is assumed to be required in order to bring units to specified standards, before the PHAs would assume responsibility for future maintenance. The Administration's plan would eliminate about 100,000 current units that would require the most extensive repair, and would fund $1.7 billion in improvements between

1984 and 1987 to bring the remaining units up to specified standards. S. 1338, by contrast, is not explicit about whether any units are to be removed from the stock and what standards units should meet, and so does not estimate the interim funding for CIAP.

Comprehensive Change

The final approach--recommended by the Administration--would be to provide the PHAs with one subsidy to cover both current operations and capital improvements, based on the costs of operating privately owned rental units. In effect, the federal government would not subsidize public housing by more than the amount required to assist households to live in private units. The argument for such a change is that present programs contain no means of determining whether the costs of public housing are reasonable, and that it is not efficient to spend more on public housing than on other comparable programs that assist households renting privately-owned units. On the other hand, public housing may differ significantly from private housing in terms of the households assisted and the services provided, in which case the operating costs of public housing could legitimately differ from those in the private market.

Under the Administration's proposal, public housing subsidies between 1984 and 1988 would total \$8.4 billion, of which \$6.5 billion would be assumed to be for operations and \$1.9 billion for improvements, though there would be no requirement that PHAs distribute subsidies in this manner (see Summary Table 3). In addition, as noted, the units most in need of repair would be eliminated from the stock, and the Comprehensive Improvement Assistance Program would be continued through 1987 to bring the remaining units up to minimum standards. Under the Administration's plan, total funding, including transitional modernization funds, would thus be nearly 50 percent lower than if the real level of aid provided in 1983 was extended through 1988; whether this would be sufficient to reach and maintain current quality standards for the remaining units is unclear.

In general, PHAs in the Northeast, where the operating costs of public housing are generally higher than those of modest private housing, would receive lower subsidies intended for ongoing operations under the Administration's plan than they would otherwise. PHAs in other regions would generally, though not always, receive higher amounts. It is difficult to compare the effects of the Administration's plan on modernization efforts, since CIAP funds are distributed on a discretionary basis and since the precise location of high-cost units that would be eliminated is not known.

SUMMARY TABLE 3. PROJECTED FUNDING LEVELS UNDER CBO REESTIMATE OF ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SUBSIDY SYSTEM AND COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM (CIAP), 1984-1988 a/

	1984	1985	1986	1987	1988	1984-1988
			(dollars per unit per month)			
FMR Subsidy	126	127	129	132	134	648
Transition Funding for CIAP b/	109	76	53	31	--	269
			(millions of dollars)			
FMR Subsidy	1,630	1,670	1,690	1,710	1,730	8,430
Transition Funding for CIAP b/	1,400	1,000	700	400	--	3,500

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office February 1983 economic forecast.

a. These estimates of the cost of the Administration's proposal vary from the Administration's estimates for several reasons. First, they exclude costs assumed to be funded outside the FMR system, such as payments to U.S. territories. Second, the Administration's estimates include the effects of proposals to count payments under the Food Stamp program as income in determining rent charges and to raise the maximum increase in rents from 10 percent to 20 percent a year. Other differences arise because of differences between the Administration's economic forecast and that of the Congressional Budget Office. Finally, the data bases used in producing the two sets of estimates vary, producing minor differences in the results.

b. This is the budget authority required to pay the debt service on bonds issued to finance CIAP activities.

CHAPTER I. INTRODUCTION

Since 1937, the public housing program has been one of the major federal vehicles for improving the housing conditions of low-income households, currently aiding 1.2 million households or about one-third of all those receiving assistance. The federal government pays the entire debt-service costs of initial construction and subsequent modernization of public housing and, in addition, subsidizes ongoing operations. The system for setting these subsidies--particularly for modernization and operations--has been the focus of growing criticism on the grounds that it lacks incentives for efficient management and is inequitable in its distribution of funds. Several major proposals have been made this year to modify federal support for public housing, and the House and Senate Banking Committees have each reported housing legislation that deals extensively with public housing.

This report considers the issues that currently surround federal subsidies for public housing, and options for addressing them. The remainder of this chapter provides background on the development of the public housing program and the shift of federal emphasis away from public housing toward subsidies for households renting in the private market. Chapter II describes the households served by public housing and the current condition of the public housing stock. Chapter III outlines the major issues surrounding the public housing program. Chapter IV explains the system used to support public housing, and the concerns that have been raised about it. Chapter V describes options for modifying federal subsidies, either through adjusting current subsidy programs or by developing an entirely new system.

THE DEVELOPMENT OF THE PUBLIC HOUSING PROGRAM

The public housing program was created as part of federal efforts to stimulate employment and offset the effects of the Depression. 1/

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1. For further discussion of the development of the public housing program, see: The Department of Housing and Urban Development, Alternative Operating Subsidy Systems for the Public Housing Program (1982); Robert Kolodny, Exploring New Strategies for Improving Public Housing Management, prepared for the Department of Housing and Urban Development, 1979; Robert Moore Fisher, Twenty Years of Public Housing (Harper and Brothers, 1959).

At its beginning, the public housing program was the only direct federal housing assistance program, and the federal role was limited to paying the capital costs of construction. Since then, the program's goals have shifted toward improving the housing conditions of low-income households, with a resulting increase in program costs. Concurrently, other programs to aid low-income households have been developed that rely heavily on privately owned housing.

The Federal Role in the Public Housing Program

The earliest federal support for publicly owned housing--other than for wartime and other special efforts--came during the 1930s, as the federal government initiated various programs to stimulate employment. Public housing was first funded through the Works Progress Administration; the subsequent Housing Act of 1937 established the U.S. Housing Authority and the process--still used today--whereby local public housing authorities (PHAs) develop and own housing projects financed through federal subsidies. Initially, public housing tenants were generally households experiencing temporary economic hardship, and public housing was explicitly not intended to assist very poor households that were unable to pay the necessary rent levels. The federal government paid only the capital costs of housing projects developed and operated by PHAs. 2/ Tenant rents were expected to cover all operating and maintenance costs and, in actuality, often covered a share of the capital costs as well.

The Housing Act of 1949 shifted the emphasis in public housing, focusing on the need for clearing slums and for assisting those households, particularly with low incomes, that were poorly housed. Eligibility for public housing was limited to lower-income households, and construction cost limits were adjusted to encourage the development of public housing for large families. These program changes, in conjunction with the widening private housing opportunities available to moderate-income households, meant that public housing served increasingly poorer households. In 1950, the median income of public housing tenants was over 60 percent of the U.S. median; by 1975, it was only 30 percent of the U.S. median. 3/

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2. Public housing is financed through long-term bonds that are issued by local public housing authorities and sold in the private market. The federal government pledges to pay the full principal and interest payments on the bonds.

3. Alternative Operating Subsidy Systems for the Public Housing Program, p. 49.

As public housing tenants became relatively poorer, PHAs found it increasingly difficult to collect rents adequate to cover rising operating costs. In response, the Congress in 1961 authorized supplemental operating subsidies to PHAs on behalf of certain tenants who were thought unable to pay rent levels adequate to meet operating costs. Payments were originally made on behalf of elderly households; in 1964 they were extended to households displaced by urban renewal activities; and beginning in 1968 they were provided for the lowest-income households and very large families.

These special payments were not sufficient to hold down rent levels, however, so the Congress passed a series of amendments between 1969 and 1971, limiting allowable rent levels for public housing to 25 percent of household income and authorizing additional subsidy payments to offset the resulting decreases in rental income. The effect of these amendments--referred to as the Brooke Amendments, after their sponsor, Senator Edward Brooke--was to boost operating subsidies from less than $5 million in 1968 to $103 million in 1971. Since that time, operating subsidies have continued to increase as the aging of the public housing stock and rising operating expenses have pushed operating costs up faster than rent collections. In 1971, operating subsidies of $103 million represented about 8 percent of PHA expenditures; by 1982, operating subsidies had grown to $1.3 billion, or nearly half of PHA budgets. In 1981, the Congress legislated an increase in the rent charged public housing tenants--as well as households aided under other programs--from 25 to 30 percent of income, to be implemented over a five-year period. 4/ This will slow, but not eliminate, the increase in future operating subsidy needs.

While the capital costs of construction and operating subsidies represent the bulk of direct federal aid for public housing, the federal government also finances the modernization of public housing units. 5/ Originally PHAs were expected to fund improvements from their operating funds. By 1968, it was clear that PHAs could not afford to offset the deterioration in the public housing stock out of their rent collections, so the Congress began additional payments for capital improvements. 6/ The value of capital

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4. This was done through the Omnibus Budget Reconciliation Act of 1981, Public Law 97-35.

5. Some communities use other federal assistance, such as Community Development Block Grant funding, to aid public housing.

6. These are financed in the same way that initial construction is financed. The only difference is that the bond term is up to 40 years for initial construction and is 20 years for modernization.

improvements financed by the federal government averaged about $300 million annually from 1969 through 1980--or $3.5 billion in total. Since then, the amount of capital improvements has increased substantially--to an average of $1 billion a year between 1981 and 1983--in an effort to bring deteriorated public housing units up to basic standards of adequacy.

The Role of Public Housing in Federal Housing Assistance

While the federal role in assisting public housing has grown over time, the public housing program has declined as a proportion of total federal housing assistance. 7/ From 1937 until 1961, the public housing program was the sole mechanism for federal housing assistance, and during that period over 460,000 units were made available (see Figure 1).

Beginning in the 1960s, other forms of federal assistance relying on the private market were developed to accompany public housing. Part of the search for alternatives was motivated by concern that housing could be more appropriately provided by the private sector, that large concentrations of poor households in public projects led to social problems, and that increases in the stock of decent quality housing could be achieved more efficiently by other means. New approaches included rent supplements to cover the difference between a share of household income designated for rent and actual rents in privately owned projects, and reduced-interest mortgages for multifamily projects that resulted in lower rents charged to low-income households. By 1972, total public housing units available numbered 990,000, while all assistance provided through other federal programs totaled 535,000 units.

In 1973, the Nixon Administration imposed a moratorium on new federal housing commitments in response to growing concern about the costs and effectiveness of the programs. In 1974, following a major review of federal housing policy, the Congress instituted a new mechanism for housing assistance, the Section 8 program, which provides supplementary rental payments to private landlords on behalf of low-income households living in existing housing, newly constructed units, or substantially renovated housing. The Section 8 program has grown rapidly into the dominant federal

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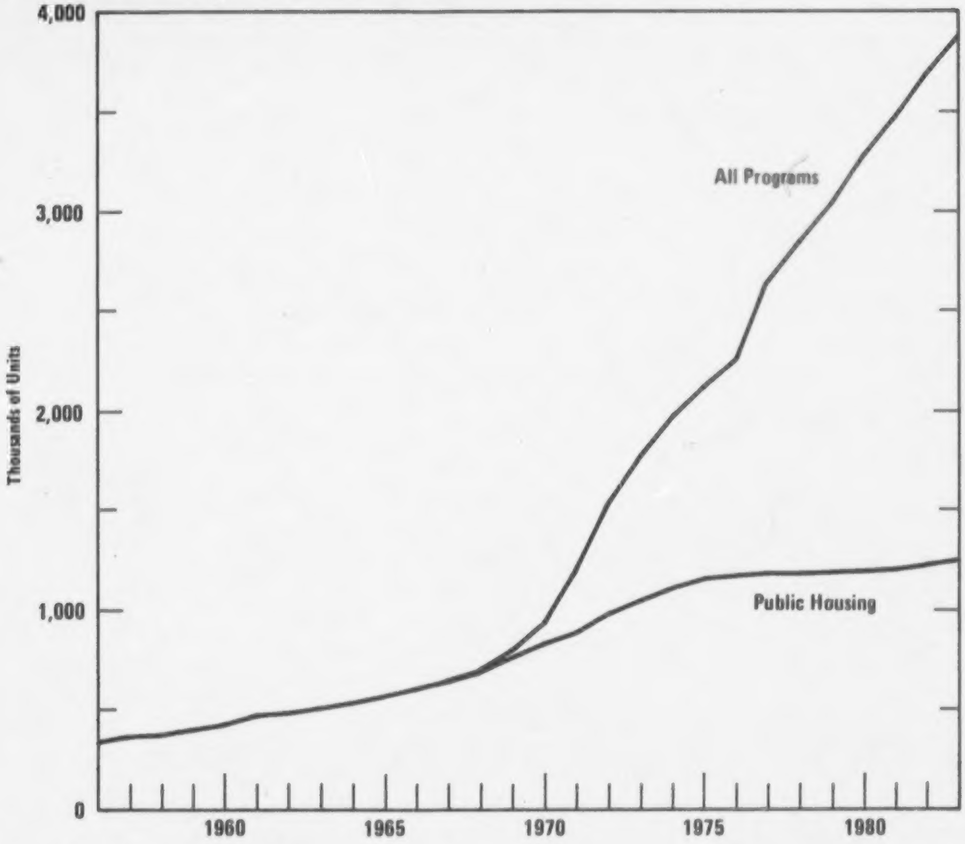
7. This discussion includes only direct federal housing assistance and does not include federal housing insurance, secondary market activities, or assistance provided through programs such as the Community Development Block Grant program. In addition, it excludes all federal aid provided through the tax system, such as the deductibility of payments for mortgage interest and property taxes.

Figure 1.

Number of Commitments Through Federal Housing Assistance Programs, 1956-1983



SOURCE: Department of Housing and Urban Development.

housing assistance program. In 1982, the public housing program aided 1.2 million households, while other federal programs assisted 2.5 million, of whom 1.6 million were recipients of Section 8 assistance.

While the supply of public housing has expanded little in recent years, public housing still provides a major share of available housing assistance--one-third of all federally assisted units in 1982. Thus, the stock of public housing remains an important, although aging, source of federal aid for low-income households.

CHAPTER II. CHARACTERISTICS OF THE PUBLIC HOUSING PROGRAM

Public housing is an important source of decent housing for particular types of households and in certain areas, and, in addition, often provides a range of supportive services for its tenants. About 1 percent of all low-income renter households and 10 percent of very-low-income renter households live in public housing, and public housing represents up to 15 percent of the rental stock in some cities. 1/ On the one hand, public housing is generally in sound condition, and many public housing authorities (PHAs), especially in urban areas, have more demand than units available. On the other hand, it is now over 20 years old, on average, and is showing signs of wear, both from the intensive use it receives and from insufficient maintenance in recent years. Further, some 7 percent of the units are in very poor condition and in need of substantial repair. This chapter describes the tenants served by public housing and the nature of the public housing stock.

WHO IS SERVED BY PUBLIC HOUSING?

The residents of public housing projects are primarily very poor households. Eligibility for public housing projects is generally limited to households with incomes below 50 percent of the area median, and the average public housing household has an income of about 30 percent of the area median. 2/ 3/ Public housing assists very-low-income households, in

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1. Low income is defined as income below 80 percent of the area median, which is the definition of eligibility for most types of federal housing assistance established by Public Law 97-35. Very low income is income below 50 percent of the area median. These estimates are based on the 1979 Annual Housing Survey.

2. Most of the characteristics of public housing households described in this section are from Suzanne B. Loux and Robert Sadacca, Comparison of Public Housing Tenant Characteristics: 1976 to 1979, Working Paper 1279-01 (Urban Institute, 1980). Characteristics of renter households in general are based on CBO calculations from the 1979 Annual Housing Survey.

3. Some units may be occupied by households with incomes between 50 and 80 percent of the area median. No more than 10 percent of the

part, because of policy choices made both by the Congress and by PHAs, and, in part, because at higher income levels households may have private-sector alternatives that are more attractive than public housing.

About 55 percent of public housing units are occupied by households headed by a person younger than 62 years--the definition of family households used in the program--and the remaining 45 percent are headed by an older person. Of the units occupied by elderly households, about two-thirds are located in projects occupied predominantly by elderly households, 4/ and the remainder are scattered across projects that also serve family households. Public housing serves a higher proportion of elderly households than the private rental market. On the other hand, the proportion of single-person households is roughly the same as in the private market.

Family Households

Because families in public housing are very poor, they resemble households in poverty more closely than they resemble renter families in general. Thus, while public housing has about the same average number of persons per household as privately owned rental units, family households in public housing have more children and fewer adults than unassisted renter households. 5/ Further, public housing households have more children, on average, than households participating in other federal housing assistance programs. In 1979, families in public housing had two children per household, on average, while private renter households in general had only one child per household. One-fifth of all public housing families have more than three children, while only 8 percent of the families participating in the Section 8 program are that large.

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3. (Continued)
units provided before 1982, and no more than 5 percent of the units provided after that time, may be occupied by such households, however (Public Law 97-35).

4. Projects occupied predominantly by the elderly are those with at least 90 percent of the units reserved for households headed by a person at least 62 years old.

5. The private renter households discussed in this section exclude single-person households--who are not generally eligible for public housing unless they are elderly or disabled--and households with heads 62 years or older.

Public housing families also have fewer adults present to raise children; as of 1979, only 20 percent had both husband and wife present, and 75 percent were headed by females. In contrast, 60 percent of unassisted private renter households had both a husband and a wife present, and just 28 percent were female-headed.

Gross family income for public housing tenants averaged $5,700 in 1979--somewhat over the $5,000 poverty threshold for a female-headed household with two children but well below the $8,900 median for all renter households. About half of total income for public housing families was earned through wages and salaries, while the remainder came from various income support programs. Three families in five received welfare income, most typically from Aid to Families with Dependent Children, which constituted over one-quarter of gross family income on average. Other sources of family income included Social Security, Supplemental Security Income, and unemployment benefits.

Three-quarters of family households in public housing were minorities, about 60 percent black and 15 percent Hispanic, compared to about 20 percent of unassisted renter households. The average age of the family's head in public housing was 39 years, compared to 33 years for the average unassisted family. The average family in public housing had occupied its unit for nearly five and one-half years, while the average unassisted family had been in its unit just two years.

Elderly Households

In 1979, elderly households in public housing predominantly consisted of a woman living alone: 73 percent were single women, 12 percent were single men, and 15 percent comprised a head of household and spouse. In contrast, in the private rental market, about 60 percent of elderly households were single persons, and slightly less than half of the total were single women. The gross income of elderly tenants averaged $3,900 in 1979, over 60 percent of which came from Social Security. The second largest source of income for elderly public housing tenants was Supplemental Security Income, which represented 13 percent of the total, followed by pensions and annuities, which contributed another 10 percent, and wages and salaries, which added 9 percent.

About 40 percent of elderly households in public housing were members of minority groups, primarily black with some Hispanic households, compared to about 14 percent of private renters with an elderly head. The average age of the household head in elderly-occupied units was 74 years, compared to 72 years for unassisted elderly renters. Elderly residents in public housing had occupied their units for an average of seven years, compared to eight years on average for unassisted elderly households.

WHAT ARE THE CHARACTERISTICS OF PUBLIC HOUSING?

Public housing is developed and owned by some 2,800 local public housing authorities (PHAs). The choices about whether and what type of public housing to build are made locally, although the federal government affects the decisions of PHAs through its funding policies and development guidelines. As a result, public housing units vary greatly in their location, their physical characteristics, the types of services provided, and their overall condition.

The Location of Public Housing

Public housing is predominantly located in metropolitan areas, where it represents a higher proportion of rental housing than elsewhere. By HUD definitions, the 22 PHAs classified as "very large"--those that own more than 6,500 units each--together account for over one-third of all public housing units (see Table 1). The New York City Housing Authority alone accounts for over 140,000 units, or about 13 percent of the total. The 112 large PHAs--that is, authorities owning between 1,250 and 6,500 units each--account for an additional quarter of the public housing stock. By contrast, the roughly 1,000 PHAs that each have fewer than 100 units together manage less than 5 percent of the total public housing stock.

By region, public housing units are most heavily concentrated in the Northeast, where 41 percent of the stock is located and where public housing represents 4 percent of all rental housing (see Figure 2). Public housing in the Northeast is almost exclusively in metropolitan areas, and about one-quarter of the public housing units in the region are in projects occupied predominantly by the elderly. 6/ About 30 percent of public housing units are located in the Central region where they also constitute 4 percent of the rental stock. About 80 percent of public housing units in the Central region are located in metropolitan areas, and 37 percent of the region's units are in projects occupied primarily by the elderly--the highest share in the nation. About one-fifth of the public housing stock is in the South, where it comprises 6 percent of the rental market. Public housing in the South is located more frequently in rural areas and is less frequently

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6. Characteristics of the Nation's Public Housing, unpublished data from the Department of Housing and Urban Development.

TABLE 1. DISTRIBUTION OF PUBLIC HOUSING UNITS BY SIZE OF PUBLIC HOUSING AUTHORITY AND REGION, 1980

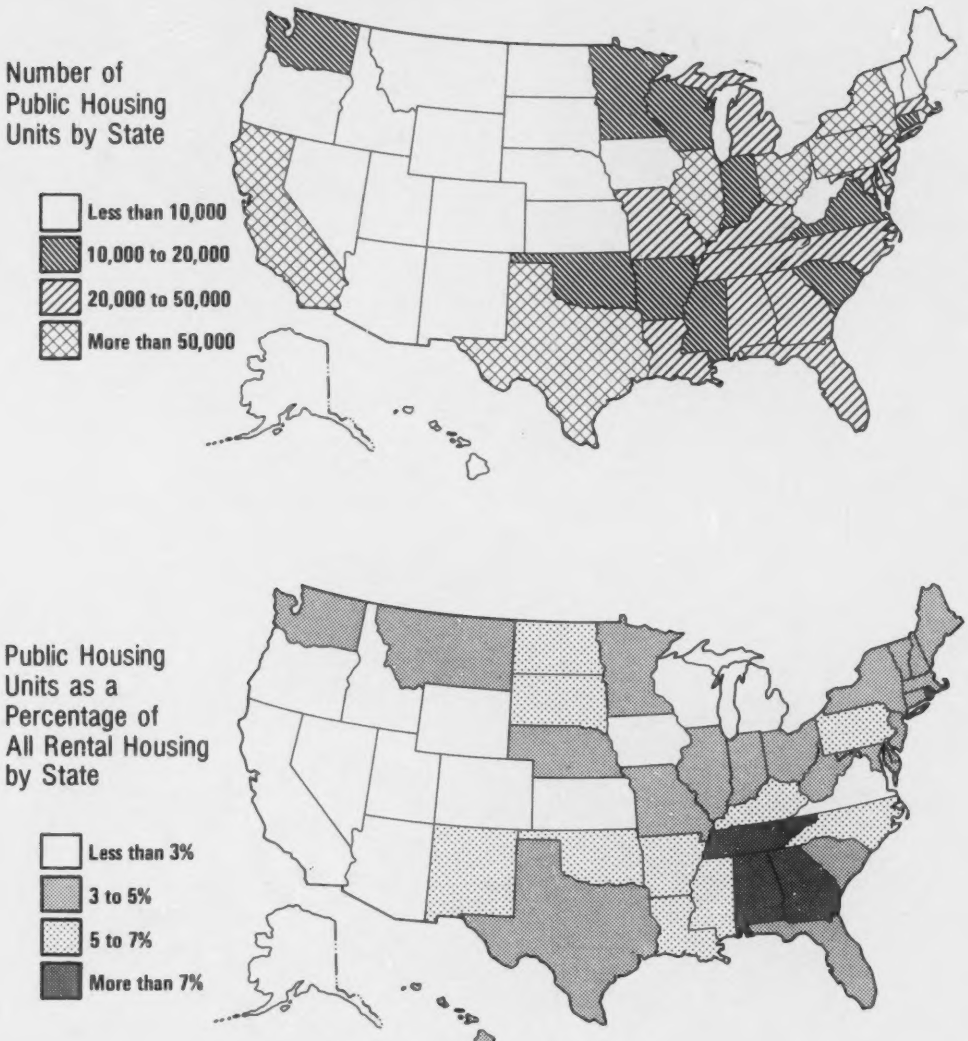
	Total		Size of Public Housing Authority[b]							
			Very Large		Large		Medium		Small	
Region[a]	Number of PHAs	Number of Units	Number of PHAs	Number of Units	Number of PHAs	Number of Units	Number of PHAs	Number of Units	Number of PHAs	Number of Units
Northeast	402	420,000	7	226,300	43	93,000	56	43,600	296	57,100
South	618	219,600	4	37,700	27	70,200	51	37,600	536	74,100
Central	954	311,000	9	108,900	30	76,400	54	39,600	861	86,100
West	223	84,800	2	15,300	12	33,000	17	12,700	192	23,800
Total	2,197	1,035,400	22	388,200	112	272,500	178	133,600	1,885	241,100

SOURCE: Department of Housing and Urban Development, Alternative Operating Subsidy Systems for the Public Housing Program (1982), p. 33, and unpublished data from the Office of Public Housing within the Department. Includes only public housing authorities that receive federal operating subsidies. About 600 public housing authorities, most of which are very small, do not receive subsidies, and account for an additional 60,000 units.

a. See Appendix A for a list of the states included in each HUD region.

b. Very large PHAs are those with 6,500 or more units. Large PHAs are those with 1,250 to 6,499 units. Medium PHAs are those with 500 to 1,249 units. Small PHAs are those with fewer than 500 units. Note that this definition of very large PHAs differs slightly from that used on other tables.

Figure 2.
Geographic Distribution of Public Housing


Number of Public Housing Units by State
Less than 10,000
10,000 to 20,000
20,000 to 50,000
More than 50,000
Public Housing Units as a Percentage of All Rental Housing by State
Less than 3%
3 to 5%
5 to 7%
More than 7%

SOURCE: Perkins and Will and The Ehrenkrantz Group, *An Evaluation of the Physical Condition of Public Housing Stock: Final Report,* prepared for the Department of Housing and Urban Development, March 1980.

reserved for elderly households units than in other regions; one-third of all units are located outside metropolitan areas and just 15 percent of the units are in projects primarily for the elderly. Only 8 percent of public housing is located in the West, where it represents 2 percent of the rental market. About 85 percent of public housing in the West is in metropolitan areas, and 30 percent of available units are in projects for the elderly.

Public housing represents an even larger share of the supply of rental units in some states and cities that have more aggressively sought and secured federal construction funding. For instance, in Alabama, 10 percent of all rental units are publicly owned, as are over 7 percent of the units in the District of Columbia, Georgia, Rhode Island, and Tennessee. Further, public housing represents 15 percent of the rental stock in Atlanta, 10 percent in Baltimore and 9 percent in Philadelphia and Cleveland. In contrast it represents 1 percent or less in such states as Idaho, Iowa, and Utah and in such cities as Los Angeles and Houston. 7/

The Physical Characteristics of Public Housing Units

The physical characteristics of public housing vary in a number of ways from those of the rental housing stock in general. The average public housing project was 17 years old in 1980, compared to an average of about 29 years for rental housing overall. Roughly one-fifth of public housing units were located in high-rise buildings--that is, buildings with seven or more stories--compared to less than 5 percent of all rental housing units. Finally, about 30 percent of all public housing units had more than two bedrooms, while less than 20 percent of rental housing units in general were that large.

These characteristics affect the relative costs of operating public and private housing in different ways. On the one hand, older projects generally have higher ongoing costs than newer ones, as major capital items and other

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7. State estimates based on CBO calculations from Department of Commerce, Bureau of the Census, Provisional Estimates of Social, Economic, and Housing Characteristics, State and Selected Standard Metropolitan Statistical Areas, PHC 80-S1-1, (1980) Table H-1. Perkins and Will and The Ehrenkrantz Group, An Evaluation of the Physical Condition of Public Housing Stock: Final Report, vol. I, prepared for the Department of Housing and Urban Development (1980). City estimates from Department of Housing and Urban Development, Alternative Operating Subsidy Systems for the Public Housing Program (1982), p. 102.

fixtures approach the end of their useful life. On the other hand, high-rise projects have higher costs than low-rise, principally because of the expense of maintaining elevators in high-rise buildings. Finally, big units cost more to manage than smaller ones, largely because of increases in the number of children per household that accompany additional bedrooms per unit. It is difficult to say how, on net, these characteristics affect the relative operating costs of public and private units.

Public housing projects that house primarily families are generally older and larger than those with large proportions of elderly tenants. 8/ Almost half of projects for families were built before 1961, while just 2 percent of units in projects for the elderly are that old. Projects containing 150 or more units represent nearly 85 percent of family-occupied units, while less than 40 percent of units in projects for the elderly are in projects that large.

These characteristics affect the operating costs of public housing in differing ways. 9/ The older age and larger size of family projects--particularly when combined with the large number of children--mean that operating costs per unit are higher for family projects than for ones for the elderly. On the other hand, studies have found that operating costs per unit fall as the number of units per project increases, suggesting that there are some economies of scale. This means that the larger size of projects for families may produce some savings, but not enough to offset additional costs that are associated with other characteristics.

Services Provided Through Public Housing

The major goal of the public housing program is to provide safe and sanitary housing for low-income households, but the Congress also allows other forms of supportive services to be provided to tenants. These include, for example, counseling on a range of concerns such as housekeeping, child care, and budget and money management; and direct and referral services for employment and training, education, welfare, and health needs.

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8. See Characteristics of the Nation's Public Housing, unpublished data from the Department of Housing and Urban Development.

9. For a discussion of the costs of operating public housing projects of different types, see: Sally R. Merrill and Stephen D. Kennedy, Improving the Allocation of Operating Subsidies in the Public Housing Program: A Revised PHA Cost Equation and Range Test, prepared by Abt Associates, Inc., for the Department of Housing and Urban Development (1982).

Most public housing authorities offer some social services to tenants. Types of programs include day care centers; recreation and playground facilities to meet the needs of family residents; family counseling and homemaker training, which is frequently viewed as important since PHAs have little control over tenant selection; and group activities for elderly tenants such as craft programs and shopping trips.

Because these services are provided at the discretion of PHAs, there is probably wide variation from one to another, although little information has been collected about differences within regions or among types of PHAs. As of 1978, PHAs on average devoted roughly 2 percent of their nonutility budgets to social services, with small and rural PHAs generally thought to spend less than other size groups. These figures may underestimate the commitment of PHAs to social services, however, since many PHAs may support some of these activities through volunteer efforts or through other federal programs that are not included in their budgets. 10/

The Condition of Public Housing

A common image of public housing is of poorly maintained projects in deteriorated neighborhoods. While some public housing is in need of substantial improvement--most often the large family projects located in big cities--available evidence suggests that, by and large, public housing is in reasonably good condition and could, with additional investment, continue for some time as a source of decent housing for low-income households. Two surveys have been done of conditions in public housing, one a study of overall project quality and the second a survey of rehabilitation needs.

Survey on Overall Conditions in Public Housing. In 1979, HUD conducted a survey to identify "troubled" public housing projects, those experiencing social, financial, managerial, and physical problems. The survey relied both on subjective evaluations made by HUD officials, PHA managers and tenants, and other housing professionals, and on more objective criteria against which projects could be judged, such as project design and site, physical condition, tenant behavior, neighborhood quality, and administration. The results of the two methods were then combined to

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10. See: Shirley Mansfield and others, Evaluation of the Performance Funding System: Working Paper on Changes in Public Housing Agency Finances, prepared by Abt Associates, Inc., for the U.S. Department of Housing and Urban Development (1980), pp. 26-30.

identify untroubled, relatively untroubled, and troubled public housing projects. 11/

Using this two-part approach, two-thirds of public housing projects were classed as untroubled, one-quarter were considered relatively untroubled, and 7 percent were classed as troubled. By number of units, 55 percent were untroubled, 30 percent were relatively untroubled, and 15 percent were troubled.

Most old large family housing projects were not troubled, although about 9 percent of projects for families were identified as troubled, compared to less than 2 percent of projects for the elderly. Similarly, 14 percent of older projects for families were considered troubled, versus 10 percent of the newer ones. Within the group of older projects for families, 28 percent of large projects were troubled, compared to just 6 percent of the smaller ones.

By definition, projects classed as troubled had more serious physical and social problems than nontroubled projects and, in addition, were more likely to suffer from management deficiencies. Among the physical problems were inadequate heating and plumbing systems, poor project design, high density, poor project siting, and lack of adequate security. The social problems included vandalism, crime in neighborhoods surrounding the projects, and the effects of a small number of disruptive tenants. Among the management deficiencies cited were lack of resources and skills to meet the multiple problems of these projects and a general lack of management ability in some cases.

Survey of Rehabilitation Needs of Public Housing. HUD commissioned a major survey to estimate the costs of improving the physical condition of projects and found that up to $8.9 billion in improvements would have been required in 1980, depending on the standards used. 12/ In 1984 dollars, the costs would be up to $10 billion, depending on the assumptions employed,

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11. For further detail see: Ronald Jones and others, Problems Affecting Low-Rent Public Housing Projects, Department of Housing and Urban Development (1979).

12. This discussion considers only costs for rehabilitating public housing and increasing its energy efficiency. The survey also estimated the cost of increasing the accessibility of public housing units to the handicapped, which is not reported here. Including the costs of increasing accessibility would add about $300 million (in 1980 dollars) to the total.

and would require up to $20 billion in budget authority, if the improvements were financed through long-term bonds as modernization projects currently are. The results of the survey--referred to as the Perkins and Will Study, after the contractor that performed the work--have been used since that time as a guide in distributing modernization funds. 13/

Three quality levels were used to evaluate the physical condition of public housing. Level I represented basic health and safety standards, and included the cost of such activities as repairing gas leaks or broken stairs. Level II was based on HUD's minimum property standards and on guidelines for rehabilitating existing structures, and included nonemergency maintenance activities such as replacing roof flashing and repointing mortar joints in brick walls to prevent major capital expenses in the future. Level III included additional rehabilitation work and amenities, elements of good design, and above-standard materials, intended to ease maintenance efforts and increase overall project quality.

The Perkins and Will evaluation found that public housing was, in most cases, basically sound--well built and in satisfactory condition. The survey discovered, however, some chronic problems such as deteriorated roofs, poor or irregular trash removal, and unreliable elevator operation in projects for families. In addition, a small group of projects, generally for families, was considered to be "distressed." Distressed projects were those that would require per-unit expenditures over $2,500 to meet Level II standards, a cutoff selected because expenditure needs above this level were generally not the result of normal deterioration but rather of problems associated with vandalism. Further, the study noted that these projects often experienced other problems, such as poor management and security, and cautioned that--unless corrected--such conditions would reduce any long-term benefit of capital improvements to these projects.

Almost all public housing units--95 percent--needed some improvement to meet even the minimum standards required for basic health and safety, Level I, but the average cost of bringing units into compliance was relatively small--$290 per unit, or about $260 million in total in 1980 dollars (see Table 2). The units most in need of basic repair were those in large, high-rise, family projects, particularly those with vacancy rates above 10 percent, which would require nearly $1,600 per unit to meet basic standards. In contrast, units in projects designed for the elderly required only an

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13. For further detail, see: Perkins and Will and The Ehrenkrantz Group, An Evaluation of the Physical Condition of Public Housing Stock: Final Report, vol. I, prepared for the Department of Housing and Urban Development (1980).

TABLE 2. COST OF MEETING VARIOUS PUBLIC HOUSING CONSTRUCTION STANDARDS (In 1980 dollars per unit)

Project Type	Cost of Meeting Basic Health and Safety Standards (Level I)a/	Cost of Meeting Minimum Property Standardsb/ (Level II)a/	Cost of Meeting Above-Minimum Standards (Level III)a/
All Projects	287	1,256	6,545
Family Projects	320	1,560	7,060
200 or more units	300	1,730	6,380
Fewer than 200 units	350	1,270	8,210
Elderly Projects	60	520	4,280
Total for All Projects (in millions of dollars)	259	1,506	6,791

SOURCE: Perkins and Will and The Ehrenkrantz Group, An Evaluation of the Physical Condition of Public Housing Stock: Final Report, vol. I, prepared for the U.S. Department of Housing and Urban Development (1980), pp. 62-96.

a. See text for description of standards at each level.

b. Includes the costs of meeting basic health and safety standards (Level I).

average of $60 per unit in repairs, reflecting both their more recent construction and the less intensive use they receive.

The average cost to meet HUD standards for necessary maintenance, Level II, was estimated at $1,250 per unit--including the $290 per unit required to meet basic health and safety standards--or $1.5 billion for all public housing units. Again, large, high-rise, family projects--particularly high-vacancy projects--required the highest per-unit expenditures to meet minimum property standards, while projects for the elderly required the lowest expenditures.

Only 7 percent of all public housing units were considered to be distressed, but these units accounted for 40 percent of the funding required to bring all units up to Level II (see Table 3). The average cost of improving distressed units was estimated at $7,200 per unit, with units in large, family high-rise projects having the highest costs--over $14,000 per unit, on average. About 11 percent of all large family projects were classed as distressed, while just 6 percent of small family projects and less than 1 percent of elderly projects were. The survey did not, however, identify the distribution of distressed units by region, which--if known--could aid in allocating modernization funds.

An average of $6,500 per unit would be needed to meet the Level III standard, or $6.8 billion in all. Cost estimates in this category were more uncertain than others, however, because much of the work estimated to be necessary was dependent on the initial characteristics of projects and the prevailing area standards. Types of activities included at this level would be the addition of entry porches in areas where they are common, development of recreation sites, and the removal of parking areas from isolated to more visible and safer sites.

The survey also considered a wide range of investments to reduce energy consumption in public housing projects and concluded that a total investment of about $2.2 billion, roughly $2,000 per unit, would reduce annual utility costs by half. The type of activities to be undertaken would vary considerably by region and project type, but included adding storm windows, storm doors, weatherstripping, and timed thermostats.

The cost of modernizing public housing in 1984 would depend on the number of units to be maintained in the stock and the standard that units were to meet, along with the rate of deterioration in public housing stock since 1980 and the uses of modernization funds allocated between 1980 and 1983. If all current units--even distressed ones--were to be repaired to meet Level III standards, and if energy-related activities were included, then the cost of improvements could total $10 billion. If these improvements were financed as modernization activities currently are, they would require $20 billion in budget authority to cover the 20-year debt service payments. Removing some share of current units or selecting a different standard would lower these costs. These estimates could be refined by examining the costs of rehabilitation projects undertaken since 1980, but to date HUD has not compiled such information.

TABLE 3. COSTS OF REPAIRING DISTRESSED UNITS TO MEET MINIMUM PROPERTY STANDARDS

Project Type	Number of Distressed Units a/	Distressed Units as Percent of all Units of Project Type	Cost per Unit to Meet Standards (In 1980 dollars)
All Projects	86,386	7	7,200
Projects for Families b/			
Large High Rise	23,539	12	14,350
Large Low Rise	40,766	11	4,740
Small High Rise	512	2	2,560
Small Low Rise	19,989	7	4,410
Projects for the Elderly b/			
High Rise	0	--	--
Low Rise	1,579	2	2,570

SOURCE: Perkins and Will, and the Ehrenkrantz Group, An Evaluation of the Physical Condition of Public Housing Stock: Final Report, vol. I, prepared for the U.S. Department of Housing and Urban Development (1980), p. 86.

a. Distressed units are those for which the repair costs to meet minimum property standards would exceed $2,500. See text for details.

b. Large projects are those with 200 or more units, while small projects have fewer than 200 units. High-rise projects are those with five or more stories and those with a combination of high-rise and low-rise buildings. Low-rise projects are those with buildings that have fewer than five stories.

CHAPTER III. ISSUES IN SUBSIDIZING PUBLIC HOUSING

The public housing program has, since its establishment in 1937, often been a focus of controversy. Through the years it has been used to promote additional policy goals, including renewal of urban areas, decentralization of low-income households, and desegregation of housing. These activities were frequently resisted, often by the residents of neighborhoods in which PHAs proposed that public housing projects be constructed, as well as by those who opposed public ownership of housing in principle. These tensions have largely subsided as the number of public housing units added to the stock has declined in recent years.

The current concern about public housing is whether or how to support an important but aging source of housing assistance. Federal costs--for debt service on construction and modernization and for operating subsidies--have risen from $810 million in 1972 to $2.9 billion in 1982 and, if 1983 levels of service were continued, could increase to as much as $4.2 billion in 1988. These rising costs, coupled with concern about the manner in which subsidies are allocated, have focused Congressional attention on public housing and have led to the proposals for change currently included in H.R. 1 and S. 1338, which are discussed in the following two chapters.

Decisions about the level of funding and the subsidy mechanisms for public housing involve broader issues, including:

- Whether to maintain all units currently in the public housing stock;
- What standards to set for public housing; and
- How closely to oversee the management of public housing.

These questions are interrelated, and choices about one will have ramifications for the others, as discussed later in this chapter.

SIZE OF THE PUBLIC HOUSING STOCK

Current federal policy seeks to maintain the public housing stock essentially at present levels by providing few new units and by restricting the conditions under which units may be removed from the stock. Since the average age of public housing units is now over 20 years, and at least some are in need of substantial renovation, a major issue is whether it may be less costly to eliminate some units and to assist the same number of households through other subsidy mechanisms. Since public housing units are owned by local public housing authorities (PHAs), the federal government cannot unilaterally decide to remove units--just as it cannot add them--but it can influence PHA decisions through the ease or tightness of the regulations governing removal, and through its funding policy.

Under current practice, PHAs are sharply restricted in their ability to remove units formally from the public housing stock. To do so, they must determine that the units are unusable and cannot be rehabilitated, and must relocate the tenants and replace the units. Removal of units must be approved by the Assistant Secretary of Housing. In 1980, fewer than 2,400 units--or 0.2 percent of the total--were eliminated from public housing.

In addition to these restrictions, PHAs may have an incentive to allow badly deteriorated units to remain vacant. HUD continues to provide operating subsidies for vacant units so that, if operating costs for vacant units are lower than the subsidies, vacant units may be of financial advantage to a PHA. From the federal point of view, however, costs are being incurred, both for debt service on the initial construction and any subsequent modernization bonds and for operating subsidies, without assistance being provided to low-income households.

A decision to modify present policies on eliminating public housing units would depend in part on the costs of continuing current units--the sum of current debt service, operating subsidies, and modernization needs--as against the costs of eliminating units and providing subsidies through alternative mechanisms. Further, the Congress would need to consider whether the alternative mechanisms would serve to replace the types of units being removed. For example, families with more than three children experience great difficulty participating in the Section 8 existing housing program; less than one-quarter of those accepted in the program are able to find suitable private-market housing within 60 days. 1/ This suggests that, at least in some markets, public housing units with several bedrooms might not be readily replaced through private-market alternatives. Deciding which, if any, units to remove from the stock would require cooperation between the federal government and the PHAs, with the results depending on the characteristics of specific public housing projects and on the alternatives available within particular localities.

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1. The Report of the President's Commission on Housing (1982), p. 41.

STANDARDS FOR OPERATING PUBLIC HOUSING

A second major issue is the standards for services provided through public housing projects. These include the housing units themselves, the surrounding common areas and grounds, and the network of supportive services for tenants. Although under current practices PHAs determine the level and mix of services, the federal government affects these decisions through the degree of control it exercises over PHAs' management decisions, the mechanisms used to allocate funding, and the level of funding provided.

One specific question is the extent to which the federal government should set standards for public housing, and the extent to which PHAs should have flexibility to set their own standards. Currently, PHAs are responsible for deciding the level of supportive services to provide and the types of ongoing maintenance to fund--which, in turn, affects the physical quality of the units. On the other hand, the federal government sets the funding levels for public housing, which limits the feasible choices. Further, the federal government allocates modernization funds, determining which PHAs receive funds and what activities are undertaken. If it chose, the Congress could require that certain types of standards and services be provided to all public housing tenants--such as a basic health and safety standard, or access to job placement information, or babysitting services for working mothers. But it would have to ensure that these could be supported with the funding available to PHAs, or else permit the PHAs to reduce the number of units they maintained. Or, it could increase PHAs' flexibility, for example by providing formula-based funding for improvements, though it might want to establish guidelines for the use of funds to ensure that they were used to improve the quality of public housing.

A second, related question is the extent to which standards could or should be similar from program to program. While all federal housing assistance programs intend that assisted households should occupy decent housing and pay rents based on standard shares of their income, the varying approaches of particular programs will always mean that services will not be comparable across some dimensions. For example, recipients of Section 8 existing-housing aid may select units from a range of opportunities in the private market, while public housing recipients generally have little choice in unit selection. Also, public housing tenants live in projects composed solely of assisted households, while such segregation is not a necessary part of other federal assistance programs. On the other hand, tenants in the public housing program may receive a range of supportive social services not offered by private rental managers.

Just as it is difficult to compare the housing services provided from program to program, it is also difficult to compare costs to determine whether similar households receive similar treatment under different programs. For example, some households, such as large, female-headed ones, are more expensive to aid than others, such as elderly-headed ones. Thus, programs that aid relatively high proportions of large families will have relatively high average costs. Housing costs also vary across the country, so if programs differ in the geographic distribution of aid, costs will also vary. Finally, program costs vary over the short and long term, making it important to consider both in any effort to standardize costs.

Thus, in considering standards for services provided in the public housing program, the Congress will need to weigh the extent to which they should be federally required, as well as the extent to which similar households should receive treatment that is as similar as possible under all federal programs. As with other public housing issues, the outcomes will both affect and be affected by the type and level of subsidies provided.

DEGREE OF FEDERAL CONTROL OVER THE MANAGEMENT OF PUBLIC HOUSING

A third issue is the degree to which the federal government should constrain the management of public housing. Since the federal government extensively subsidizes public housing and contributes a large and growing share of PHA budgets--now nearly half--it is appropriate to ensure that federal funds be used to support federal policy goals. On the other hand, it is also important to ensure that federal constraints do not hinder the achievement of these goals.

The federal government affects the management of public housing directly through regulations and management oversight, and indirectly through the incentives contained in funding mechanisms. Current federal regulations apply to numerous aspects of PHA operations, including rent levels, admissions and evictions policy, wages of employees, and contracting and purchasing procedures. While the regulations are intended to ensure that federally subsidized activities meet federal standards and that assistance is efficiently provided, they may also add to PHA costs by increasing the time spent in documenting compliance and by limiting flexibility in decisionmaking.

HUD also oversees PHA management. Its field offices review PHA activities on an ongoing basis through reports that PHAs must supply and through scheduled on-site reviews. 2/ While this oversight enables HUD to ensure that federal policies are being implemented and to assist PHAs experiencing management difficulties, it also imposes costs on the PHAs. Further, because HUD must review all PHAs, it has only limited time to devote to those that are experiencing significant management difficulties.

Finally, the current system for subsidizing public housing includes incentives that shape PHA behavior. These incentives, described in more detail in the following chapter, affect such aspects of public housing management as: the amount of energy used by PHAs, the manner in which tenant incomes are certified and rents collected, the treatment of vacant units, and the amount of funds held in reserve. Most incentives are designed to increase the efficiency of PHA operations, although--as in the case of vacancy policies discussed earlier--not all do.

In considering the amount of federal control that should be exercised over the management of public housing, the Congress may wish to add to PHAs' incentives or flexibility in order to increase their management efficiency. Such possible efficiency gains should be weighed, however, against the value of requirements to ensure that public housing activities meet federal standards.

BROADER IMPLICATIONS OF FUNDING MECHANISMS

The current system of funding determines operating subsidies by a formula based on past costs, and sets modernization subsidies on a separate and discretionary basis. While these approaches were developed in response to problems with earlier methods, they have been criticized as inefficient and inequitable. The proposals before the Congress would modify the amount of subsidies for public housing and the way they would be allocated. As this discussion has indicated, however, changes in current subsidy mechanisms have wider implications.

Changes in the amount of subsidies would affect the standards for public housing projects and the numbers of units that could meet them. The costs of improving public housing to different levels of quality vary considerably, and at any given standard some units may cost as much as 30 times more than others to repair. Thus, at any given funding level, tradeoffs will exist between the number of units to be operated and the

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2. HUD field offices make annual on-site visits; biennial occupancy audits and engineering surveys; and quadrennial management and utility reviews.

standards that such units will meet. Further, the level of near-term funding will affect the long-term costs of public housing. An increase in current funding could lower future costs if it was used for preventive maintenance or for activities that lowered operating costs. Conversely, reduced funding now might lead to higher costs or decreased quality, if needed maintenance had to be postponed.

Changes in the manner in which subsidies are allocated would also affect the quality of public housing. The Congress could choose, for example, to eliminate the current practice of earmarking subsidies for operations or for modernization and to allow managers more flexibility in setting standards and allocating funds. This approach could lower the costs or raise the quality of public housing if PHAs were able to increase their efficiency, though it could have the opposite effect if PHAs found it difficult to develop long-range strategies for operating and maintaining public housing. Standards might also vary more in both the short and long run. For example, standards could rise in the near term if PHAs increased spending for current operations, but could fall in the long run if PHAs were later unable to finance needed capital improvements.

Thus, the proposals now before the Congress to modify the current mechanisms for supporting public housing must be judged in terms of the number of public housing units to be supported, the services to be provided, and the degree of federal oversight to be exercised. Conversely, decisions about these issues--whether explicit or implicit--would determine the funding required for public housing and the resulting federal costs.

To help the Congress assess the alternatives before it, Chapter IV describes the current financing mechanisms and discusses concerns that have been voiced about specific features of them. Chapter V discusses the general approaches to setting federal subsidies for public housing and specific proposals to modify current programs, along with their costs and some of their implications.

CHAPTER IV. THE CURRENT SYSTEM FOR SUBSIDIZING PUBLIC HOUSING

The federal government subsidizes public housing in three ways. It first pays the debt-service costs of constructing public housing, and then it pays the debt-service costs of subsequent modernization. In addition, it provides operating subsidies to cover the difference between tenants' rent payments and operating costs. In 1982, total federal subsidies for public housing were $2.9 billion, or $2,400 per unit.

In recent years, federal costs for operating subsidies and modernization have risen sharply. Between 1972 and 1982, operating subsidies rose from $21 per unit per month to $95, or from $245 million to $1.3 billion in total--up nearly fivefold in a decade. Similarly, $900 million worth of modernization improvements were authorized in 1982--which will require $1.8 billion in debt-service payments spread over 20 years--up from $200 million worth of improvements provided in 1972.

Federal subsidies for operations are currently provided through the Performance Funding System (PFS), and subsidies for modernization are provided through the Comprehensive Improvement Assistance Program (CIAP). Both programs were intended as major reforms in previous subsidy programs, but each has come under growing criticism in recent years. The current programs and the concerns raised about their operation are the subject of this chapter.

SUBSIDIES FOR ANNUAL OPERATIONS

When the Congress limited rents to a fixed share of tenants' incomes in 1969, it also agreed to make contributions to public housing authorities' operating budgets to help fund the resulting gap between operating expenses and rent collections. Initial subsidies were determined by calculating the difference between each authority's expected expenditures and anticipated revenues. Subsidies in subsequent years were calculated by reviewing PHAs' budgets, and adjusting each upward by an estimate of inflation. Annual reviews of each PHA's budget were time-consuming, however, and allowed much discretion on HUD's part in setting funding levels. Further, because PHAs could often count on the federal government to cover revenue shortfalls, the system did not encourage efficient operations and led to rapidly rising costs.

In an attempt to simplify the system for awarding subsidies and to promote efficiency, HUD instituted the Performance Funding System in 1975. The PFS serves two primary functions. First, it is the means of estimating operating subsidy needs for public housing each year and becomes the basis of a funding request to the Congress. Second, it is the vehicle used by HUD to allocate appropriated operating subsidies among PHAs.

Under the PFS, federal subsidies are generally appropriated to cover the difference between allowable operating costs and anticipated rental income. Subsidies are forward-funded; that is, they are provided at the start of a fiscal year to finance ongoing operations. HUD sets a formula-determined allowable expense level (AEL) for each PHA and separately estimates utility and audit costs, all based on past levels for that PHA.[1] The PHA's income is also projected, and its subsidy is the difference between anticipated expenses--the sum of the AEL, utility costs, and audit costs--and income.

$$\begin{matrix}\text{Operating} \\ \text{Subsidy}\end{matrix} = \begin{matrix}\text{Non-utility} \\ \text{Allowable} \\ \text{Expense} \\ \text{Level}\end{matrix} + \begin{matrix}\text{Utility} \\ \text{Costs}\end{matrix} + \begin{matrix}\text{Audit} \\ \text{Expenses}\end{matrix} - \begin{matrix}\text{PHA} \\ \text{Income}\end{matrix}$$

To the extent that public housing managers can operate at lower levels than HUD has projected, the additional funding is available for increased service levels or other uses, but to the extent that total funding is lower than required, managers must increase efficiency, reduce service levels, or attempt to secure assistance from local governments or private sources.

A key characteristic of the Performance Funding System is that, although it is called a "cost-based" subsidy system, operating subsidies are based on past funding levels, not on the actual cost of providing some specified level of public housing services. The alternative to this procedure--defining a desired level of services to be provided, and estimating the annual costs of achieving that service level for PHAs of varying types and locations--was considered when the Performance Funding System was instituted, but was rejected as too difficult. Basing operating subsidies on past funding levels makes the system relatively easy to administer, particularly for the large number of PHAs that receive annual subsidies. On the other hand, it makes it more difficult to assess whether PHAs in similar circumstances receive similar levels of federal assistance.

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[1] HUD requires PHAs to have a biennial audit of their finances.

Allowable Expense Levels

Allowable expense levels (AELs) were established in 1975 for each PHA and have been adjusted annually since then for the effects of inflation and changes--particularly due to age--in the housing stock. They include all expenses except those for utilities and audits--that is, they include personnel costs, routine maintenance, security, social service activities, and payments to local governments in lieu of property taxes.

Initial Allowable Expense Levels. Allowable expense levels were initially set for all PHAs on the basis of the expenses of a group of 56 PHAs judged to be well managed by HUD officials, PHA personnel, tenants, and housing researchers. The operating costs of these PHAs were accepted as reasonable, and were used to establish a range of allowable operating costs. 2/ Expense levels for other PHAs were set at then-current levels if they fell within the designated range, and were increased thereafter for inflation and for changes in the housing stock. PHAs with operating expenses above the allowable range had subsidy levels fixed at then-current levels until subsequent adjustments raised the range of allowable costs.

The intention in basing allowable costs for all PHAs on the standard of well-managed PHAs was to promote efficient operation of public housing, but the manner in which it was instituted has been criticized as underestimating the operating costs of large urban PHAs, particularly those in distressed areas. 3/ For one, some of the factors that affect public housing operating costs--such as the prevailing area wage levels, vandalism experienced at a PHA, and conditions in neighborhoods surrounding a PHA's projects--were not included among the factors considered in setting cost levels, thus not accurately representing the conditions experienced by large PHAs. Further, the manner in which the costs of the group of well-managed PHAs were generalized to all PHAs had the effect of raising AELs of

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2. The range was established by examining the relationship between current expense levels and several characteristics of PHAs. The characteristics examined were: average age of project buildings, average height of buildings in floors, average number of bedrooms per unit, the effect of regional costs on PHA operating expenses, and the number of people in the area served by the PHA.

3. For a detailed examination of technical issues surrounding the Performance Funding System, see: Sally R. Merrill and others, Evaluation of the Performance Funding System: Technical Components, Decision Rules, and Administration, prepared by Abt Associates, Inc., for the Department of Housing and Urban Development (1980).

relatively small PHAs and lowering those of large PHAs from the levels at which they would otherwise have been. As a result, large urban PHAs were much more frequently above the allowable range than other PHAs, and were unable to appeal the results.

Adjustment for Inflation. AELs have been updated each year since 1975 for the impact of inflation on operating costs. Until 1982, the measure of inflation used to update AELs was an index of local government wage rates. But because wages represent only about 60 percent of nonutility operating costs, the measure was changed in 1982 to a composite of local government wage rates and state and local government purchases, weighted 60 percent and 40 percent respectively, to reflect the major components of PHAs' budgets. 4/ The wage rate component is available for 426 local areas, while the purchases measure is available only on a national basis.

Because operating subsidies are funded in advance, AELs are updated by the anticipated level of inflation, not the actual level. During the recent years of high rates of inflation, the increases in PHA operating costs were consistently underestimated, resulting in a real decline in operating funds available to PHAs. When the new index was introduced in 1982, all AELs were adjusted to offset the underestimates between 1977 and 1981, but PHAs did not receive additional subsidies for earlier years and no provision has been made for such adjustments on a regular basis in the future.

Adjustment for Changes in the Public Housing Stock. 5/ The adjustment for changes in the public housing stock is calculated separately for each PHA and is based on: average building age, average building height, average unit size (in numbers of bedrooms), and metropolitan area population. 6/ The formula generally increases allowable expense levels by less than 1 percent a year, and has often been criticized as too complex relative to its small effect on operating subsidies.

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4. The state and local purchases index includes government spending for durable and nondurable goods, structures, and nonemployee services. A fifth component of the state and local government purchases index, employee compensation, is omitted to avoid double counting of the effects of wage rate changes.

5. This adjustment is often referred to as the "Delta" adjustment.

6. Although at one time Fair Market Rents for the area served by a PHA were also included, they were subsequently omitted.

Utility and Audit Costs

Utility costs are a major and growing share of public housing operating expenses, representing 40 percent of the total in 1982; audit costs, by contrast, are very small, representing about 0.1 percent of total expenses that year. In general, utilities and audits are treated under the Performance Funding System as expenses beyond the control of PHAs.

Allowable utility costs are based on projected consumption and rate levels. The consumption base is the average level over the three previous years, and the rate is either the one currently in effect or--if known--the rate for the coming year. At the end of each year, projected utility expenses are compared to actual levels. All increases in costs resulting from rate increases not included at the start of the year are paid by the federal government. Any savings or additional costs resulting from consumption below or above the base-period level are shared equally by the PHA and the federal government, providing the PHA an incentive to conserve energy.

HUD requires that PHA accounts be audited once every two years, and even PHAs that do not receive operating subsidies may have their audit expenses reimbursed by HUD.

PHA Income

The major source of a PHA's income--other than federal subsidies--is rent collections from tenants, with a smaller sum coming from interest earned on its investments. Rental income is projected by increasing the end-of-year average rent per unit to the expected level for the coming year. The average anticipated rent per unit is then multiplied by the number of units expected to be occupied.

In 1981, the Congress decided to increase tenants' rents from 25 to 30 percent of their adjusted incomes, and to limit the authority of PHAs to set rent ceilings and deductions from income. The effect of these provisions will be to increase rent collections and decrease the need for federal subsidies. 7/ For new tenants the increase was effective at the start of 1982, while for current tenants the increase is being phased in by increasing rents by 1 percent of income a year, with all tenants paying 30 percent by

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7. For further discussion of this point see: Department of Housing and Urban Development, Alternative Operating Subsidy Systems for the Public Housing Program (1982), Chap. 2.

1986. 8/ Even when fully implemented, rent collections will probably not go up by a full 20 percent, however. The rise in rents will probably make public housing less attractive than private-sector alternatives to a small number of higher-income tenants. Such tenants are likely to move out and be replaced by poorer tenants, who would pay lower rents for their units.

Several incentives are incorporated into the way the rent projections are made, which vary in their effects on public housing managers. First, PHAs are not allowed to make deductions for tenant delinquencies, thus prompting them to keep tenants current in their rent payments. Second, although PHAs may request an adjustment if projected rental income is higher than actual, no adjustment is made if projected levels are lower than actual. When PHAs had more flexibility in setting rent levels this was intended to provide an incentive to PHAs to increase rents. Now that the flexibility has been removed, it merely allows PHAs whose tenants' incomes have increased faster than anticipated to keep the increase. Finally, although vacant units are excluded from the count of revenue-producing units, they are counted in the number of units available for subsidy. Thus, if operating subsidies are higher than operating costs of vacant units, it may be financially advantageous to PHAs to hold vacant units.

A smaller source of income for PHAs, about 7 percent of the level of rent collections, is interest income. Most interest is earned on PHAs' reserves, though funds allocated to PHAs for modernization--described later in this chapter--may be held for short periods and may also accumulate interest. PHAs must count this income in determining federal subsidies, which creates a disincentive for maintaining large reserves.

Total Operating Subsidies

The annual operating subsidy provided by the federal government is the difference between a PHA's estimated expenses and its income. In 1982, operating subsidies averaged $95 per unit per month and ranged from $140 for very large PHAs to $36 for small ones (see Table 4). Most of the variation came in PHA expense levels. Nonutility allowable expense levels ranged from $77 to $153--a 100 percent variation. Utility costs varied from $55 per unit per month to $96--or 75 percent. Revenues varied much less, ranging, on average, from $90 per unit to $110.

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8. The legislation also includes a provision that tenants' rents may not rise more than 10 percent a year because of the increase, so a few tenants may not yet be paying 30 percent of income by 1986.

TABLE 4. COMPONENTS OF OPERATING SUBSIDIES UNDER THE PERFORMANCE FUNDING SYSTEM, BY SIZE OF PUBLIC HOUSING AUTHORITY, 1982 (In dollars per unit per month)

		Size of Public Housing Authority (PHA) a/			
	All PHAs	Very Large	Large	Medium	Small
Average Expenses					
Allowable Expense Levels	117	153	106	94	77
Utility Expenses b/	79	96	77	68	55
Total	196	249	183	162	132
Average Income					
Rent Collections	94	104	83	95	90
Other Income c/	7	6	7	8	7
Total	101	110	90	103	97
Average Subsidy d	95	140	93	60	36
Total Subsidy e/ (In millions of dollars)	1,184	784	180	110	111

SOURCE: Congressional Budget Office.

a. Very large PHAs are those with 6,600 or more units. Large PHAs are those with 1,250 to 6,599 units. Medium PHAs are those with 500 to 1,249 units. Small PHAs are those with 100 to 499 units.

b. Includes costs of audits and miscellaneous expenses.

c. Includes primarily interest earned on reserves.

d. Expenses less income.

e. This estimate excludes operating costs calculated outside the Performance Funding System, such as subsidies for Puerto Rico and the territories, and consequently is lower than the level reported in the President's budget for 1984.

By region, operating subsidies in 1982 were more than twice as large in the Northeast as in the West--$132 per unit per month compared to $60 (see Table 5). The largest part of this variation came in utility expenses, which were over twice as high in the Northeast as in the West--reflecting differences both in climate and in the average age of the public housing stock. As a result of the variation in subsidies, northeastern PHAs, with 40 percent of the units, received 60 percent of the subsidies, while western PHAs, with 8 percent of the stock, received 5 percent of the subsidies.

SUBSIDIES FOR MODERNIZATION

The second component of ongoing federal subsidies for public housing is the Comprehensive Improvement Assistance Program (CIAP), which provides funding to modernize public housing projects. Federal subsidies for major improvements date to 1968, when it became apparent that annual funding levels were insufficient to fund capital improvements to the public housing stock. The current modernization program was established in 1980 to address perceived shortcomings in previous modernization efforts.

Until 1981, the federal government provided about $290 million annually in capital improvements to public housing. HUD field offices allocated funds on a discretionary basis that reflected HUD priorities. The most frequent use of early modernization funding was building improvement, including such activities as repair or replacement of heating systems, exterior walls, kitchens, and bathrooms.

These modernization efforts were criticized both because ongoing maintenance decisions were divorced from modernization decisions and because of the lack of flexibility in setting goals. Separating maintenance from modernization meant that PHAs had an incentive to defer maintenance activities until modernization funds could be obtained, thus discouraging cost-effective choices between maintenance and major improvements. This was particularly true when adjustments for inflation were lagging behind actual cost increases so that PHAs were faced with real reductions in operating subsidies. Further, because HUD determined the priorities for allocating funds, PHAs could not be certain that funds would be available for various activities when needed. [9]

The goal of CIAP is to give PHAs authority for planning modernization activities and to avoid funding activities on a piecemeal basis. To that end,

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9. For further discussion of these points, see: Alternative Operating Subsidy Systems for the Public Housing Program, Chap. 7.

TABLE 5. COMPONENTS OF OPERATING SUBSIDIES UNDER THE PERFORMANCE FUNDING SYSTEM, BY REGION, 1982
(In dollars per unit per month)

	All PHAs	Region a/			
		Northeast	South	Central	West
Average Expenses					
Allowable Expense Levels	117	145	87	102	121
Utility Expenses b/	79	110	59	60	48
Total	196	255	146	162	169
Average Income					
Rent Collections	94	117	71	78	102
Other Income c/	7	7	7	7	8
Total	101	124	78	85	110
Average Subsidy d/	95	132	68	77	60
Total Subsidy e/ (In millions of dollars)	1,184	693	160	277	55

SOURCE: Congressional Budget Office.

a. See Appendix A for a list of the states included in each HUD region.

b. Includes costs of audits and miscellaneous expenses.

c. Includes primarily interest earned on reserves.

d. Expenses less income.

e. This estimate excludes operating costs calculated outside the Performance Funding System, such as subsidies for Puerto Rico and the territories, and consequently is lower than the level reported in the President's budget for 1984.

CIAP finances complete modernization for selected projects, with the intent of funding subsequent capital replacements for these projects out of a capital reserve fund.

CIAP has funded an average of nearly $1 billion annually in improvements since 1981. 10/ Funds are allocated among HUD regional offices based on the distribution of needs identified in the Perkins and Will study described in Chapter II, with HUD regional offices encouraged, though not required, to use these estimates in allocating funds within the region. PHAs submit proposals for the modernization of selected projects, and HUD field offices select projects on the basis of urgency, management feasibility, long-term cost savings, and degree of tenant and local government support. Little is known to date about the precise nature of the activities undertaken with CIAP funds, or the costs per unit to achieve comprehensive modernization, though HUD officials have begun to tabulate such data. When available, this information could be used to gauge progress toward meeting the rehabilitation needs of public housing, described in Chapter II.

Although CIAP addresses some of the problems associated with earlier modernization efforts, several issues remain. First, with limited funds available, comprehensive modernization means that some projects receive extensive improvements while basic repair needs in other projects go unmet. Second, because these funds continue to be allocated independently from operating funds, PHAs still lack incentive to consider the long-term consequences of ongoing maintenance decisions. Finally, although the original intention of the comprehensive modernization program was to establish a capital reserve fund for each project when its modernization was complete, this component has never been funded.

PROJECTED SUBSIDY LEVELS

Operating subsidies for public housing are projected to total $7.4 billion between 1984 and 1988, based on the Performance Funding System as currently structured, and $7.4 billion of capital improvements could be made if the 1983 level of services continued through 1988. Since improvements are financed through 20-year bonds, however, as much as $15 billion in budget authority would be needed for modernization over this period, making the total budget authority requirements for public housing subsidies nearly $23 billion over the five-year period.

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10. The total costs for 1981 to 1983, including debt service, will be $6.1 billion, spent over the 20-year term of the bonds issued to finance the work.

Operating subsidies under the Performance Funding System are expected to average $106 per unit per month in 1984 and to rise by 13 percent to $120 per unit by 1988 (see Table 6 and Appendix Table B-1). Total operating subsidies are expected to be $1.4 billion in 1984 and to increase by less than $200 million by 1988. 11/ The slow growth projected in operating subsidies is due in large part to the anticipated effects of increases in rents charged to public housing tenants from 1984 to 1988. Nonutility allowable expense levels under the Performance Funding System are projected to increase by 23 percent during the period, and utility costs to grow by 19 percent, while rent collections are projected to grow by 28 percent. 12/

Subsidies for modernization are set on a discretionary basis--rather than a formula basis--by the Congress each year, making it difficult to project future levels. In 1983, $1.3 billion in improvements was funded, at a total cost of $2.6 billion over the 20-year period that these expenses will be financed. Extending the same real level of capital improvements financed in 1983 through 1988 would require $15 billion in budget authority to finance $7.4 billion in capital improvements.

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11. It should be noted that these projections are based on past trends and do not consider the effects that current modernization efforts could have on costs. In particular, expenses for utilities could be lower in the future than in the past because of energy-saving improvements.

12. These estimates of the effects of the increase in rents are based on projections made by HUD. Other estimates are based on assumptions consistent with the Congressional Budget Office February 1983 economic forecast. For further detail, see: Congressional Budget Office, The Outlook for Economic Recovery (February 1983).

TABLE 6. PROJECTED FUNDING LEVELS UNDER THE PERFORMANCE FUNDING SYSTEM (PFS) AND THE COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM (CIAP), 1984-1988

	1984	1985	1986	1987	1988	1984-1988
	Average Funding Level (dollars per unit per month)					
Operating Subsidies Through the PFS a/	106	111	114	117	120	568
Modernization Subsidies Through the CIAP b/	213	220	230	241	252	1,156
Total	319	331	344	358	372	1,724
	Total Funding (millions of dollars)					
Operating Subsidies Through the PFS a/	1,370	1,470	1,500	1,530	1,550	7,420
Modernization Subsidies Through the CIAP b/	2,740	2,900	3,020	3,140	3,260	15,060
Total	4,110	4,370	4,520	4,670	4,810	22,480

SOURCE: Congressional Budget Office. More detailed projections and estimates of funding by size of public housing authority and region are included in Appendix B.

a. Includes only subsidies to PHAs calculated under the PFS and excludes subsidies calculated outside the PFS, such as those for Puerto Rico and the U.S. territories.

b. This is the budget authority required to fund the same real level of services each year as is being financed in 1983. The level of improvements that would be made would be roughly half of the budget authority amount.

CHAPTER V. OPTIONS FOR SUBSIDIZING PUBLIC HOUSING

The current mechanisms for subsidizing public housing were intended as major reforms, but over time they have come under increasing criticism. Concern about the Performance Funding System has focused on the manner in which funding levels are established and on the incentives it provides for efficient management. 1/ Questions about the Comprehensive Improvement Assistance Program have centered on the incentive it gives to postpone routine maintenance of public housing, where possible, until such time as modernization funds are available, and the inefficiencies that may result.

These concerns have led to a wide-ranging set of proposals for modifying current subsidies, and the Congress is considering two bills--H.R. 1 and S. 1338--that would change present practices (see Appendix C for a summary of the two bills). In general, the options are either to modify existing programs in relatively modest ways or to substitute an alternative approach to subsidizing public housing. Many observers would argue that the current levels of services provided through public housing are generally appropriate and that, while there may be difficulties with existing programs, it is preferable to adjust them rather than to substitute entirely new ones. Others--particularly within the Administration--argue that the current system lacks a mechanism for comparing public housing costs to other federal housing program costs, and that to spend more for public housing than is spent on providing assistance through the other programs is inefficient.

This chapter first outlines the general approaches to setting subsidies, and then considers options for subsidizing the public housing program.

SETTING SUBSIDY LEVELS FOR PUBLIC HOUSING

The current subsidy mechanisms could be modified in numerous ways to address recent concerns, as the range of options in the following sections indicates. In considering these options, at least two fundamental questions must be resolved:

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1. For a further discussion of the perceived strengths and weaknesses of the PFS see: Department of Housing and Urban Development, Alternative Operating Subsidy Systems for the Public Housing Program (1982), pp. 17-23.

- Whether to provide subsidies for operations and improvements jointly or independently; and

- What standards to use in setting funding levels.

The major proposals to modify public housing subsidies would address these questions in different ways. The House and Senate Banking Committees would continue to base operating subsidies on past costs through the Performance Funding System, though with some modifications. The Senate committee would additionally use PFS-defined operating costs as the basis for determining funding for capital improvements, thus providing operating and modernizing funds jointly. The Administration proposed this year, in its 1984 budget submission, a more comprehensive alternative whereby funding for operations and improvements would be provided jointly, but total funding would be based on the cost of providing comparable assistance through privately owned housing.

Separate Versus Joint Subsidies

One major consideration in designing subsidy systems for public housing is whether subsidies should be specifically designated for operations and for improvements. Their current separation reflects at least in part the evolution of federal involvement in public housing. When tenant incomes were no longer sufficient to cover operating costs, the federal government began contributing to ongoing costs. Later, when the stock became too deteriorated to maintain through current operating funds, the federal government established subsidies for modernization, including major capital improvements.

Whether subsidies should continue to be made separately for operations and improvements depends largely on the purpose they are to serve and on the relative ability of public housing managers to allocate funds. If the modernization of public housing units is regarded as essentially a one-time operation--when units are updated to current standards by replacing kitchen and bath features, augmenting wiring, improving energy efficiency, and so forth--then it may be logical for these funds to be viewed independently from operations, since the activities are not part of ongoing maintenance but, rather, one-time investments that will not be repeated in the near term. On the other hand, if modernization activities include types of activities that must be undertaken more regularly--replacement of broken fixtures and repair of roofs and heating systems, for example--then it may be reasonable to consider the outlays as operating expenditures, particularly since the level of current maintenance would affect future repair costs.

Current modernization subsidies skirt these questions. They are intended to provide comprehensive improvements, not to finance repair and maintenance needs. Because of limited operating budgets, however, CIAP funds are used for these activities as well. Further, while major repairs are meant to be financed from a capital reserve fund, moneys for this have never been explicitly appropriated, leaving open the question of how to meet future capital requirements.

Whether subsidies for improvements and operations should be provided jointly or independently will also depend on whether PHA managers can design effective investment strategies. If PHAs were given responsibility for the full range of operating and maintenance decisions, as private housing managers have, they would have an incentive to make cost-effective choices from among available alternatives. On the other hand, if they increased spending for current operations so that funding was unavailable for future repairs, then the quality of the public housing stock could erode or the Congress could feel required to provide supplemental subsidies.

Standards for Public Housing Subsidies

The standard for subsidy levels in public housing has always been controversial. A major rationale for using past levels has been that they are readily known and that PHAs have been able to operate at those levels. On the other hand, under such a system it is difficult to assess, first, whether overall funding levels are adequate and, second, whether individual PHAs are performing efficiently.

The major alternative to basing operating costs on past levels would be to peg them to the private-market operating costs used to set subsidy levels in other federal programs. The argument for this system is that, if public housing cannot be operated at levels comparable to private-market housing, then assistance would be more efficiently channeled through other means. The opposing argument is that private-market rent levels may not be reasonable measures of public housing expense levels.

OPTIONS FOR MODIFYING THE PERFORMANCE FUNDING SYSTEM

The two major sets of concerns raised about the PFS are the manner in which subsidies are calculated and the incentives offered for efficient management. These concerns could be addressed, at least in part, through incremental changes in the current system.

Setting Subsidy Levels Under the PFS

Subsidy levels under the PFS could be modified in at least four ways, by:

- Adjusting allowable expense levels;
- Reconciling differences between expected and observed levels of inflation;
- Reconciling differences between predicted and actual tenant rents; and
- Simplifying the annual adjustments for changes in the public housing stock.

Modifying Allowable Expense Levels. The goal of the PFS was to induce high-cost PHAs to operate more efficiently so as to lower their expenses to the levels of well-run PHAs, but the procedure used may have incorrectly identified some PHAs--particularly large urban ones--as inefficient and may have underestimated their operating expenses. The Congress could offset these underestimates either by increasing the nonutility allowable expense levels of large urban PHAs or by establishing an appeals process so that PHAs that believe that their subsidies are inappropriately low may request that HUD review and possibly increase their AELs. H.R. 1 would incorporate both an adjustment to the AELs of authorities operating in distressed areas and an appeals process into the Performance Funding System.

Because much of the data that would be needed to recompute initial allowable expense levels for each PHA no longer exist, adjustments would require using a proxy to identify those PHAs that had their actual operating costs underestimated. One option would be to increase allowable expense levels for PHAs located in communities receiving above-average per capita allocations under the Community Development Block Grant (CDBG) program. 2/ The CDBG program provides grants on an entitlement basis to large cities and urban counties, with localities in distressed areas receiving larger per capita grants than other, less distressed places. Thus, the recipients of above-average community development grants are, by and large, the types of communities in which initial AELs for public housing were underestimated. Under this option, PHAs in these communities would

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2. See: Alternative Operating Subsidy Systems for the Public Housing Program, Chap. 4.

receive subsidy increases of about 5 percent on average, with the exact amount depending on the extent to which the community development grant for that community exceeded the average grant. Very large PHAs, and PHAs located in the Northeast and Central regions, would receive adjustments more frequently than would other types, reflecting the distribution of CDBG funds.

If such an adjustment was made in 1984, subsidies would increase by about $40 million. Since CDBG allocations would only serve as a proxy for underfunded PHAs, the result might be to overcompensate some PHAs and undercompensate others--as would also be true if other proxies were used to adjust funding levels.

Another way to increase subsidies for PHAs that may be currently underfunded would be to establish an appeals process whereby HUD officials could review, on a case-by-case basis, the circumstances of individual PHAs. While such a process could avoid the difficulties of using a proxy and could allow adjustments to offset more recent changes in PHAs' operating circumstances not reflected in the PFS, it could increase HUD's administrative expenses and could be an also imprecise means of adjusting subsidy levels if HUD officials were inconsistent in their response to appeals.

The features of an appeals process could vary in many ways. It could be limited to only those PHAs that believed that their initial funding was too low or could be open to any PHA that felt that its current funding was inappropriate. Appeals could be allowed only for a limited period, or could be incorporated as an ongoing component of the subsidy system. Finally, the amount by which subsidies were allowed to increase could either be left to the judgment of HUD officials or could be established by formula. For example, an allowable range for public housing operating costs could be established on basis of recent research about the factors that affect costs, and PHAs could be allowed to appeal up to amounts within this range. 3/ The costs of such a system and its effects would depend on how these questions were resolved.

Reconciling Differences Between Expected and Actual Inflation. A second difficulty is that allowable expense levels are updated each year by the anticipated level of inflation, not the actual level. Unlike estimated

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3. Sally R. Merrill and Stephen D. Kennedy, Improving the Allocation of Operating Subsidies in the Public Housing Program: A Revised PHA Cost Equation and Range Test, prepared by Abt Associates, Inc., for the Department of Housing and Urban Development (1982).

utility costs that are reconciled with actual levels after the close of the year, no adjustment is made for differences between expected and actual inflation. Such adjustments would help ensure that but they could also add to the complexity of the system. Both H.R. 1 and S. 1338 would modify it in this manner.

One question in making adjustments is whether subsidies themselves should be retrospectively raised or lowered, or whether only the allowable expense levels on which subsidies are based should be adjusted. Because the data on actual rates of inflation would not be available by the close of a year, retrospective adjustments for actual inflation would also lag. Adjusting subsidy levels would mean that funding levels over time would reflect actual levels of inflation, but the timing of such adjustment could pose problems. For example, if inflation were predicted at 6 percent and reached only 4 percent in one year, PHAs would receive a 2 percent reduction in subsidy two years later. If in the subsequent year inflation were projected at 6 percent, PHAs would receive a net increase of 4 percent. If, however, actual inflation in the subsequent year were 8 percent, then funding would be 4 percent less than actual costs. Conversely, PHAs could be relatively overfunded in other years if inflation was over predicted. Thus, while, on net, subsidies would reflect actual costs, the lag in adjustments could produce short-term funding difficulties.

An alternative would be to adjust allowable expense levels each year by the most recent actual rate of inflation before projecting them to future years, but not to adjust past subsidy levels. This was the procedure used in 1982 when expense levels were updated. On the one hand, this would prevent allowable expense levels from straying further and further away from the actual levels, as they could if, for example, inflation were consistently underestimated. It would also prevent PHAs from receiving larger or smaller subsidies in the current year than are expected to be required. On the other hand, it would mean that PHAs would not necessarily receive the same real level of subsidies over time.

The effects of retrospective inflation adjustments on federal costs would depend on how the adjustments are implemented, but they would probably be small. In 1982, a one-time retrospective adjustment to allowable expense levels was made for underestimates of inflation between 1977 and 1981, raising them by 4.9 percent. This increased federal subsidies by $67 million in 1982 and will increase future year subsidies over the levels they otherwise would have reached. This estimate, however, probably overstates the costs of future adjustments, because a large part of the increase resulted from the substitution of the composite index of wages and purchases for the former index that relied solely on wages (see Chapter IV for details).

Reconciling Differences Between Expected and Actual Tenant Rents. Operating subsidy calculations could also be modified by reconciling subsidy estimates for the differences between expected and actual tenant rents. Currently, the average rent at the end of a year is raised by an assumed rate of increase in tenant incomes to calculate a PHA's rental income in the coming year. While an appeals process exists to raise subsidies for PHAs where rents are not rising as rapidly as expected, no mechanism exists to recapture subsidies where rents were higher than expected.

Establishing a system of year-end adjustments to rent revenues would lower federal costs, though the exact amount would depend on how much more rents increased than expected, and would also end additional subsidies to PHAs whose tenants' incomes rise faster than expected. On the other hand, it would add somewhat to the complexity of the subsidy system. Further, it would require that PHAs carefully monitor their revenues during a year and set aside the amounts that were more than anticipated, to offset the reduction in the following year's subsidy.

Simplifying the Annual Adjustment for Changes in the Housing Stock. Another concern raised about subsidy calculations is the manner in which the annual adjustment is made for changes in the public housing stock. The adjustment is small--between 1977 and 1981, it averaged from 0.1 to 0.7 percent--and its calculation is complex.

One option would be to replace the current adjustment factor, which varies for each PHA, with a constant factor for all PHAs. This would simplify the estimation of this factor every year, but would not allow for the impact of adding new units or substantially improving existing ones.

Alternatively, the current practice of estimating the change factor could be limited to PHAs experiencing some major change in their stock of units, and a constant factor applied to the remaining PHAs--the approach included in H.R. 1. This would be somewhat more complicated than using a single adjustment factor, but simpler than the current system. In either case, such modifications would have negligible effects on federal costs.

Increasing Management Incentives Under the Performance Funding System

The PFS is designed as an incentive-based system: public housing managers are provided a formula-determined expense level and, to the extent that they keep actual costs below this level, are able to use the excess funds as desired. Incentives for PHA managers to perform their tasks efficiently could be expanded, however, thus potentially reducing federal costs or increasing the assistance provided.

Providing Full Subsidies Only for Occupied Units. At present, federal subsidies cover all units managed by a PHA unless HUD and the PHA have formally agreed to withdraw a unit from the stock. This means that PHAs do not have incentives to minimize the duration of vacancies, and to the extent that this reduces rent payments it raises federal subsidy costs. Further, since vacant units are more apt to be vandalized than occupied ones, it may increase the need for federal modernization funds.

PHAs could be encouraged to maintain full occupancy by reducing subsidies for units that are vacant longer than is required for tenant turnover. The strongest incentive would be to provide no subsidy for vacant units. S. 1338 would eliminate subsidies for vacant units in excess of 2 percent in 1984, in excess of 1 percent in 1985, and for all vacant units beginning in 1986.

On the other hand, even vacant units require some expenditure for heat, security, and other needs. Another option would be to provide subsidies for a limited period of time and then to eliminate subsequent subsidies, unless the vacancy was necessary for planned modernization work. Or, partial subsidies could be provided for part or all of the vacancy period. For example, in the Secton 8 new construction program, subsidies equal to 80 percent of rent levels are provided for 60 days. Making some adjustment for vacancies would increase management incentives, but it would also increase the complexity of subsidy calculations under the PFS.

The effect of limiting subsidies for vacant units would depend on the manner in which the limit was applied and on the effect it had on public housing occupancy rates. HUD officials estimate that vacancy rates average from 5 to 8 percent but vary widely by PHA, with some having very low vacancy rates and a few having high rates. If reducing subsidy levels for vacant units caused PHAs to increase occupancy rates, then subsidy levels--and therefore federal costs--would change little. If, however, PHAs, particularly with high vacancies, did not or could not reduce vacancy rates, then subsidies could fall by up to the vacancy rate, depending on the way the limit was applied.

Assisting Public Housing Authorities with Management Difficulties. Another option for increasing management incentives would be to reduce oversight of PHAs considered to be managed well and use the savings for increased review of those experiencing difficulties. Performance standards could be established either by the PHAs themselves through a peer process or by HUD. The Senate Banking Committee has considered both approaches.

Under the peer review process included in S. 1338, a commission to establish performance standards for public housing management would be chosen by the Secretary of HUD (see Appendix C for further details). The commission would consist of representatives of public housing authorities, local governments, and tenants who would recommend standards for the management of public housing and procedures for evaluating PHAs.

A plan, included in the housing bill reported last year by the Senate Banking Committee, would have required the Secretary of HUD to evaluate PHAs, designating them as either Tier A or Tier B authorities depending on their operations. Tier A PHAs would be eligible to receive multiyear subsidy payments from HUD and would be granted maximum flexibility in managing their affairs. Tier B agencies would receive only one-year subsidy payments and would be eligible for special assistance in order to improve management and gain accreditation.

These approaches would focus attention on PHAs experiencing management difficulties and increase HUD's oversight of them. Their success would depend on the ability of the peer review commission or HUD officials to develop and apply meaningful standards for the management of public housing and to assist PHAs that did not meet such standards. The willingness of PHAs to participate would also affect their success. The cost of such approaches would depend on the manner in which they were implemented and the extent to which current review efforts were reduced.

OPTIONS FOR MODIFYING THE MODERNIZATION PROGRAM

Two issues have been raised about the manner in which improvements to the public housing stock are planned and financed. First, because funding is available on a discretionary basis, PHAs cannot be assured of receiving funds at the time they are most needed. Thus, when funds are available, PHAs have an incentive to make repairs that could have been postponed--such as replacing all of the roofs in a project, even though only some are worn out. Second, because funding for improvements is provided separately from funding for operations, PHAs have an incentive to defer maintenance projects until Comprehensive Improvement Assistance Program funds are available, rather than performing ongoing maintenance.

Proposals have been made to fund modernization jointly with operating subsidies. Managers would then know the amounts to expect and have an incentive to consider the long-term consequences of their operating decisions. The quality of public housing might erode under such an approach, however, if funding levels were set too low or if PHAs were unable to budget efficiently and used funding intended for improvements to meet their operating expenses.

Such a formula-based program would require decisions about the scope and level of funding, the limitations to be applied to the use of funds, and the method of funding during the transition period.

Design of a Formula-Based Improvements Program

Two models for formula-based modernization have been proposed: one would provide a single source of funding from which PHAs would be expected to fund all maintenance and capital needs, while the other would provide formula-based funding for all but major capital items, the latter to be financed through a separate, discretionary grant program operated by HUD.

A Comprehensive Approach. The Administration has proposed that PHAs be provided with a single source of funding from which they would finance ongoing improvements and major capital items, as well as operations. The level of funding required to maintain the public housing stock on an ongoing basis is difficult to estimate and would depend on the standards that PHAs were expected to meet and the age of a PHA's units. The Administration has proposed that an amount equal to 20 percent of a PHA's annual nonutility operating expenses (that is, allowable expense levels under the Performance Funding System) would be sufficient to maintain HUD's minimum property standards. If funding was set at 20 percent of allowable expense levels, the program would cost $340 million in 1984 (see Table 7), and $1.9 billion for the 1984-1988 period.

The Congress might want further information before making a final decision on an appropriate funding level, however. First, the estimate that capital expenditures equal 20 percent of nonutility operating costs is based on a single year's expenditures for a sample of privately owned rental projects insured by the Federal Housing Administration. 3/ Second, even if all units met a prescribed standard--discussed later--PHAs with relatively old units might have a different pattern of capital expenditures than those with relatively newer ones. For example, even if the heating systems work equally well in a 5-year old project and a 20-year old one, it is likely that the older system will require replacement sooner than the newer one. Over the long term, expenditures might be similar for older and newer projects; in the short term, however, the spending requirements could differ widely, thus affecting the funding necessary for different PHAs to maintain the same quality standards.

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3. See: Urban Systems Research and Engineering, Inc., Capital Replacement Expenditures in FHA Multifamily Housing Projects: Implications for Addressing the Modernization Needs of Public Housing (1983).

TABLE 7. FUNDING FOR THE PERFORMANCE FUNDING SYSTEM AND A FORMULA-BASED IMPROVEMENTS PROGRAM UNDER A RANGE OF ASSUMPTIONS, 1984-1988 (In millions of dollars)

	1984	1985	1986	1987	1988	1984-1988
Performance Funding System a/	1,370	1,470	1,500	1,530	1,550	7,420
Improvements Allowance Set at 20 Percent of Allowable Expense Levels	340	370	380	400	420	1,910
Total	1,710	1,840	1,880	1,930	1,970	9,330
Performance Funding System a/	1,370	1,470	1,500	1,530	1,550	7,420
Improvements Allowance Set at 15 Percent of Allowable Expense Levels	250	280	290	300	310	1,430
Capital Reserve Fund b/	160	170	180	180	190	880
Total	1,780	1,920	1,970	2,010	2,050	9,730

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast.

a. Excludes federal subsidies for U.S. territories paid outside the Performance Funding System. Estimates of funding under the Administration's plan by size of public housing authority and region are included in Appendix B.

b. This estimate is based on actual spending for capital items between 1975 and 1979. Future levels may be higher or lower than past levels. If a capital reserve fund was financed through 20-year bonds, the budget authority requirements would be about twice as high as these estimates.

A Two-Part Approach. An alternative approach would be to provide formula-based funding for routine maintenance and a discretionary reserve fund for major capital items. Under a plan considered in a recent HUD study, three items would be eligible for funding through the capital reserve fund--roofs, heating systems, and utility distribution systems--and all remaining improvements would be funded through the improvements allowance. 4/ Under S. 1338, which also adopts this approach, the activities to be funded through each mechanism would be determined by HUD, with recommendations from the commission that would be appointed to consider management standards. In either case, HUD would retain responsibility for allocating capital replacement funds among PHAs. This approach would make it easier to take account of the different ages of PHAs' housing, since major capital items would be funded separately, but it would require continued federal involvement in PHAs' decision making.

The funding required for such a system should, over time, be the same as for a comprehensive formula-based program, but could vary considerably from year to year as capital needs varied. 5/ A survey of private housing managers has estimated that an improvements allowance equal to 12 to 15 percent of a PHA's nonutility operating costs could be sufficient to maintain minimum property standards, if a capital reserve fund was established for roofs and for heating and utility distribution systems. In the Senate plan, funding for the improvements allowance would be set at 15 percent of nonutility operating expenses, and capital reserve funds would be determined on the basis of joint recommendations from HUD and the commission.

Adding a replacement allowance set at 15 percent of allowable expense levels defined under the PFS would require $250 million in 1984 and $1.4 billion from 1984 to 1988 (see Table 7). The expenditures for a capital reserve would be difficult to project, however. If major improvements were made to public housing during the transition to a new system, presumably little funding for capital items would be needed in the near term. Without substantial transition funding for modernization, the near-term capital needs would be larger. Major capital items funded from 1975 to 1979

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4. See Alternative Operating Subsidy Systems for the Public Housing Program, Chap. 7.

5. Although funding requirements would, over time, be the same under a comprehensive and a two-part approach, actual costs could vary. Since the funding for major capital items under a two-part plan would be discretionary, the Congress might or might not provide the same amount over time as it would if it chose the comprehensive approach.

averaged $160 million per year in 1984 dollars, although there is little evidence to suggest whether future capital costs would be higher or lower than this average. If this real level of capital spending was continued through 1988, capital costs would total $880 million. If these costs were financed through 20-year bonds, as under the Comprehensive Improvement Assistance Program, then the budget authority to finance this level would be roughly $1.8 billion.

Constraints on the Use of Funds

In establishing a formula-based replacement allowance, the Congress would need to consider whether to attach limitations to PHAs' use of funds. Possible constraints could include requiring that PHAs establish a project-based capital replacement fund to ensure that future needs be met, or that they develop long-term capital plans. Some PHAs might have difficulty in planning efficiently for the expenditure of these funds, and technical assistance could be provided to help them develop plans. Such constraints could help ensure that PHAs did not use the entire federal subsidy for near-term operating expenses. On the other hand, if the intent of a formula-based replacement allowance is to shift responsibility to PHAs, then the Congress may consider such restrictions unnecessary or undesirable.

The Transition to a Formula-Based Modernization Plan

Proposals for a formula-based improvements program assume that PHAs could maintain standard-quality units if they were provided a stable and ongoing source of funds. Because some units do not currently meet such standards, as discussed in Chapter II, these proposals include a transition period during which Comprehensive Improvement Assistance funds would continue to be provided to bring some or all public housing units to prescribed standards of quality.

The CIAP funding required for a transition would depend on how many units were to be modernized and on what standards were set for improvement projects. Bringing all units in the public housing stock up to Level III standards could require improvements totaling $10 billion, and $20 billion in budget authority (see Chapter II). Under the Administration's plan, some 100,000 units most in need of repair would be withdrawn from the public housing stock; all others would be brought up to HUD's minimum property standards (Level II); and energy conservation improvements would be made. The Administration estimates that this would require $1.7 billion in improvements and $3.5 billion in budget authority, assuming that no deterioration has taken place since 1980 and that no CIAP funds since 1980 have been used on distressed projects or for activities above Level II. Under S. 1338, $1.6 billion in budget authority--enough to finance about $800 million in improvements--would be provided for CIAP in 1984, to bring as many units as possible to "habitability standards," which are not further defined. CIAP funds would be continued after 1984 only for PHAs whose units failed to meet such standards.

OPTIONS FOR BASING SUBSIDIES ON PRIVATE-MARKET RENTS

The Administration and others have proposed that current programs for subsidizing public housing be replaced with a single subsidy based on the same private-market rent standards that are used in the Section 8 existing housing program. 6/ Such an approach would modify current programs in two fundamental ways. First, it would base subsidy levels on private rent levels used in other programs, rather than on past funding levels for public housing. The Administration and others who advocate this system argue that it would provide a benchmark for determining whether funding levels for public housing are reasonable, whereas under the current system no such external standard exists. Second, PHAs would receive a single subsidy covering both operating expenses and costs of improvements. Since funding for improvements would be guaranteed rather than discretionary, PHAs would be able to plan improvements and would have an incentive to seek cost-effective means of maintaining the public housing stock.

Those opposed to the Administration's plan argue that the types of tenants served and the aid provided by public housing differ significantly from those of privately owned rental units. Further, they believe that private-market rents would overstate the operating costs of public housing in markets where private rental units are highly profitable and would understate costs where they are not. For those reasons, they maintain, private rents are not appropriate measures of public housing operating costs.

The Administration's Proposal

Under the Administration's proposal, federal subsidies for operations and for improvements would be combined into one payment based on Fair Market Rents (FMRs), which are market rent levels determined annually by HUD for over 2,500 areas in setting subsidy levels in the Section 8 existing-housing program. An FMR would be the 40th percentile of rents of all

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6. See: Raymond J. Struyk, A New System for Public Housing (Urban Institute, 1980).

standard-quality units in an area, excluding those built in the past two years. 7/ FMRs would be adjusted to reflect the distribution of units with varying numbers of bedrooms owned by each PHA, the proportion of tenants who pay their own utilities, and the number of units in family projects over five stories high. Then, from each PHA's FMR would be subtracted the lesser of the PHA's actual debt service or 20 percent of the adjusted FMR value. This cap on debt service would limit each PHA's debt-service costs to HUD estimates of the average debt service for private-market rental units.

Federal subsidies would be set at the difference between adjusted FMRs and PHA income. Under the Administration's proposal, subsidies would be paid only for occupied, standard-quality units. The Administration plan may be summarized:

$$\text{Basic Subsidy Under Administration's Proposal} = \text{Funding Level Based on Adjusted FMR} - \text{Lesser of: (1) Debt Service, or (2) 20 percent of Adjusted FMR} - \text{PHA Income}$$

The Administration also proposes a transition period during which a PHA would receive a subsidy based on the FMR unless this amount would be less than a minimum or more than a maximum subsidy level. In 1984, PHAs would receive subsidies very similar to those they would have otherwise received. In later years, the minimum would decline and the maximum would increase, so that subsidy levels could move further and further from the levels they would otherwise have reached.

In addition, the Administration would continue the Comprehensive Improvement Assistance Program through 1987 to bring all but badly deteriorated units up to HUD's minimum property standards; the units in worst repair would be removed from the stock, thus reducing the size of the inventory. The Administration estimates that this would require $1.7 billion in improvements, or $3.5 billion in budget authority, as discussed earlier.

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7. The 40th percentile is the rent that is less than 60 percent of the rents in an area and greater than 40 percent.

TABLE 8. PROJECTED FUNDING LEVELS UNDER CBO REESTIMATE OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SUBSIDY SYSTEM AND COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM (CIAP), 1984-1988 a/

	1984	1985	1986	1987	1988	1984-1988
			(dollars per unit per month)			
Subsidy for Operations b/	100	100	100	101	102	503
Subsidy for Improvements c/	26	27	29	31	32	114
Total FMR Subsidy	126	127	129	132	134	648
Transition Funding for CIAP (In dollars of budget authority)	109	76	53	31	--	269
			(millions of dollars)			
Subsidy for Operations b/	1,290	1,310	1,310	1,310	1,310	6,530
Subsidy for Improvements c/	340	360	380	400	420	1,900
Total FMR Subsidy	1,630	1,670	1,690	1,710	1,730	8,430
Transition Funding for CIAP (In millions of dollars of budget authority)	1,400	1,000	700	400	--	3,500

Subsidy Levels Under the Administration's Plan. Under the Administration's proposal, FMR-based subsidies for public housing would total \$1.6 billion in 1984 and \$8.4 billion from 1984 to 1988 (see Table 8). 8/ In addition, \$3.5 billion in budget authority--to finance \$1.7 billion in improvements--would be allocated to CIAP between 1984 and 1987, making total funding for public housing \$11.9 billion over the period.

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8. These estimates of the cost of the Administration's proposal vary from the Administration's estimates for several reasons (see Table 8, a/).

TABLE 8. (Continued)

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on public housing authority revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast.

a. Components of the FMR subsidy and estimates of funding under the Administration's plan by size of public housing authority and region are included in Appendix B.

These estimates of the cost of the Administration's proposal vary from the Administration's estimates for several reasons. First, they exclude costs assumed to be funded outside the FMR system, such as payments to U.S. territories. Second, the Administration's estimates include the effects of proposals to count payments under the Food Stamp program as income in determining rent charges and to raise the maximum increase in rents from 10 percent to 20 percent a year. Other differences arise because of differences between the Administration's economic forecast and that of the Congressional Budget Office. Finally, the use of different data bases produced minor differences in the results.

b. Total subsidy minus that portion assumed to be used for improvement needs, defined as 20 percent of nonutility allowable expense levels calculated under the Performance Funding System (PFS).

c. Defined as 20 percent of nonutility allowable expense levels calculated under the PFS.

Under the Administration's plan, PHAs would have complete discretion in allocating funds between current operations and capital improvements. If, however, capital improvements would require roughly 20 percent of nonutility operating costs, then the funding that would be available for operations under the FMR plan would total \$1.3 billion in 1984, 6 percent below the projected PFS level. It would grow by just 2 percent between 1984 and 1988, so that between 1984 and 1988 operating subsidies under the Administration's plan would total \$6.5 billion. This would be \$900 million--or 14 percent--less than projected under the PFS.

Under the Administration's plan, PHAs would also have a formula-based subsidy for improvements that would total $1.9 billion between 1984 and 1988, assumed to be equal to 20 percent of nonutility operating costs. The FMR-based improvements funding would be available for ongoing operating costs, if PHAs chose to use them for such activities, though using these funds for current operating needs could mean that PHAs would have difficulty adequately maintaining the public housing stock.

The Effects of the Administration's Plan. The Administration's plan is designed in such a way that in 1984 PHAs would receive operating subsidies similar to those that they would have received under the PFS (see Table 9). Beginning in 1985, however, the constraints that would produce such results would gradually be lifted. By 1988, 60 percent of all units would be located in PHAs receiving less for operating under the FMR system than they would have received under the PFS, and for 38 percent of all units this difference greater than 10 percent. In contrast, 22 percent of all public housing units would be located in PHAs receiving increases in their operating subsidies of over 10 percent.

By region, most public housing outside the Northeast would receive higher operating subsidies under the Administration's plan than under the PFS, while most public housing in the Northeast would receive less (see Appendix B, Tables B-5 to B-8). In 1988, when the transition would be virtually complete, PHAs in the West managing all but 21 percent of the units located there would receive at least as much under the Administration's plan as they would have under the PFS--and generally more. Similarly, PHAs managing 60 percent of the units in the South and in the Central regions would be at least as well off. In contrast, only 9 percent of the units in the Northeast would be located in PHAs that had operating subsidies at least as large as they would have had under the PFS; for 62 percent, the reduction in subsidy relative to the PFS would be 25 percent or more.

Estimating the effects of the Administration's proposal for funding improvements to public housing is more difficult. Since modernization funds are currently allocated on a discretionary basis to a limited number of PHAs each year, the change would mean that many PHAs would receive more funding than they otherwise would in any one year, and some would probably receive more than they would have over a period of several years. This could lead to improved conditions in at least some public housing projects. On the other hand, little evidence exists on the annual funding levels required to maintain the public housing stock. The Administration argues that adequate ongoing improvements could be funded with the equivalent of 20 percent of nonutility operating costs. If, however, public housing requires higher levels than private housing--because, for example, it serves larger families or is more prone to vandalism--then these levels could be

TABLE 9. EFFECTS OF THE ADMINISTRATION'S PROPOSAL: CHANGES IN OPERATING SUBSIDIES a/ FROM PERFORMANCE FUNDING SYSTEM (PFS) TO CBO'S REESTIMATES OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SUBSIDY SYSTEM, 1984-1988 (Percent distribution of public housing units) b/

Change from PFS to FMR	1984	1985	1986	1987	1988
-50 Percent or More	--	1	2	3	4
-49 to -25	1	5	22	22	24
-24 to -10	22	29	12	11	10
-9 to -1	21	12	17	21	22
No Change	57	20	14	10	5
+1 to +10	c/	28	19	15	12
+11 to +25	c/	5	12	13	13
+26 to +50	c/	1	2	4	6
+More Than 50	c/	d/	2	2	3

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office February 1983 economic forecast.

-- Indicates that no units fall within that category.

a. Operating subsidies are total federal subsidies under the Administration's FMR proposal minus the amount assumed to be necessary for improvements, which the Administration defines as 20 percent of nonutility allowable expense levels under each year's projected PFS funding.

b. These funding levels are weighted by the number of units managed by each public housing authority. The comparison includes only public housing authorities that currently receive operating subsidies under the Performance Funding System.

c. The Administration's proposal is designed in such a way that no PHA could receive an operating subsidy in 1984 larger than it would have received under the PFS.

d. Less than 0.5 percent.

inadequate. Or, if some PHAs used some of the funding assumed to be necessary for improvements for operating expenses--as could be the case for those that would experience large declines in operating subsidies--then funding for future improvements would not be available.

Whether $3.5 billion in transition funding for CIAP would be sufficient depends on the physical quality standard selected and on the assumptions made about deterioration in the public housing stock since 1980. The Administration's estimate assumes that the units identified as distressed would be eliminated and that HUD's minimum property standards would be applied. It also assumes that the stock has not deteriorated since 1980 and that funding has not been used since 1980 to upgrade badly deteriorated projects. It is likely, therefore, that even to achieve the Administration's goals would require additional funding, and the budget authority requirements for a transition modernization program could be as high as $20 billion, if the Congress chose other standards in designing the program or maintained all existing units.

Modifications of the Administration's Plan

The Congress could endorse the Administration's assertion that public housing subsidies should be set on the same basis as other federal housing subsidies, but could modify the manner in which the change was implemented. Specific possibilities include:

- Setting the FMR standard at a different point in the distribution of rents;
- Including a different segment of the market in the FMR distribution, such as only rents paid by households that have moved recently, or the rents paid by all households including those in newly built units, or rents paid by all households except those in subsidized units;
- Making additional or fewer adjustments for differences between public and private housing, in terms of the relative characteristics of both housing units and tenants served;
- Funding major capital items separately;
- Modifying the length of the transition from current programs to the new system; or
- Establishing other minimum and maximum funding levels.

The effect of such modifications would depend on the purposes for which they were intended and the manner in which they were structured. For example, the Congress could decide that FMRs should be established at the midpoint, rather than the 40th percentile, in the distribution of rents so that PHAs would have the same resources as are available to the average private manager. Or, if the Congress felt that the differences between public and private rental tenants described in Chapter II were significant enough to affect their relative operating costs, it could modify FMR levels to account for such variation. Or, the Congress could modify the length of the transition between the two funding systems, by either shortening or extending it relative to the Administration's plan.

For example, if the Congress established FMR levels at the 45th percentile in the distribution of rents paid by recent movers--a measure designed to reflect current market conditions and to allow PHAs operating levels more comparable to those of average private-market managers--total subsidies would increase to $1.7 billion in 1984 and to $9.3 billion for the 1984-1988 period. Based on the Administration's estimate that 20 percent of nonutility operating costs would be needed for improvements, total operating subsidies under this approach would be within 1 percent of the levels that they are projected to reach under the PFS. Fewer PHAs in each region would experience reductions in subsidy levels than under the Administration's plan, though a higher proportion of the PHAs in the Northeast would be adversely affected than in other regions.

Or, if the Congress determined that the operating costs of public projects with three and four bedrooms are higher than those of comparable private projects because of the larger numbers of children per household, it could increase subsidies for such units. Doing so might increase FMR-based subsidies to $1.6 billion in 1984 and to $8.6 billion for the five-year period. This would raise subsidies for PHAs in all regions, relative to the Administration's plan, and would, in particular, offset some of the large reductions that PHAs in the Northeast would otherwise experience.

Adjustments of these types to the Administration's plan could enable the Congress to set service levels for public housing at the levels considered appropriate and to ensure that the transition from one system to the other did not produce large short-term or long-term disruptions and inefficiencies. These adjustments could raise or lower costs from the Administration's plan, depending on their precise nature.

APPENDIX A. GEOGRAPHIC REGIONS

The regions used in tables in this paper are those defined by the Department of Housing and Urban Development. The states or territories included in each region are:

Northeast: Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont, New Jersey, New York, Puerto Rico, Virgin Islands, Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia

Central: Illinois, Indiana, Michigan, Minnesota, Ohio, Wisconsin, Arkansas, Louisiana, New Mexico, Oklahoma, Texas, Iowa, Kansas, Missouri, Nebraska

South: Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee

West: Colorado, Montana, North Dakota, South Dakota, Utah, Wyoming, Arizona, California, Hawaii, Nevada, Arkansas, Idaho, Oregon, Washington

APPENDIX B. DETAILED INFORMATION ON PROJECTED FUNDING LEVELS UNDER CURRENT PROGRAMS AND UNDER CBO REESTIMATES OF THE ADMINISTRATION'S PROPOSAL

TABLE B-1. PROJECTED FUNDING LEVELS UNDER THE PERFORMANCE FUNDING SYSTEM (PFS) AND COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM (CIAP), BY COMPONENT OF SUBSIDY, 1984-1988

	1984	1985	1986	1987	1988	1984-1988
	Average Funding Level (dollars per unit per month)					
PFS						
Operating Expenses a/	219	230	241	252	264	1,206
PHA Income b/	113	119	127	136	144	639
Federal Subsidy (Expenses Less Income) c/	106	111	114	117	120	568
CIAP d/	213	220	230	241	252	1,156
Total	319	331	344	358	372	1,724
	Total Funding (millions of dollars)					
PFS						
Operating Expenses a/	2,850	3,070	3,200	3,320	3,440	15,880
PHA Income b/	1,480	1,600	1,700	1,800	1,890	8,460
PFS Subsidy (Expenses Less Income) c/	1,370	1,470	1,500	1,530	1,550	7,420
Total Federal Subsidy e/	1,420	1,520	1,560	1,590	1,610	7,700
CIAP d/	2,740	2,900	3,020	3,140	3,260	15,060
Total	4,160	4,420	4,580	4,730	4,870	22,770

SOURCE: The Congressional Budget Office.

TABLE B-1. (Continued)

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast.

a. Includes allowable expense levels, utility costs, and utility adjustments.

b. Includes rent collections and interest income.

c. Includes only subsidies to PHAs calculated under the PFS.

d. This is the budget authority required to fund the same real level of services each year as financed in 1983. The level of improvements that would be made would be roughly half of the budget authority amount.

e. Includes subsidies calculated outside the PFS, such as those for U.S. territories, and other expenses such as audits.

TABLE B-2. PROJECTED SUBSIDY LEVELS UNDER THE PERFORMANCE FUNDING SYSTEM BY REGION AND SIZE OF PUBLIC HOUSING AUTHORITY, 1984 AND 1988 a/

			Size of Public Housing Authority c/							
	Total		Very Large		Large		Medium		Small	
Region b/	1984	1988	1984	1988	1984	1988	1984	1988	1984	1988
			Average Subsidy (dollars per unit per month)							
Northeast	142	159	172	195	132	149	92	101	78	84
Central	90	102	148	171	77	87	41	42	36	37
South	71	80	118	137	87	99	50	53	38	40
West	76	85	125	142	79	88	73	82	34	35
Total	106	120	156	178	98	111	63	68	48	51
			Total Subsidy (millions of dollars)							
Northeast	802	907	570	648	107	122	61	68	64	68
Central	321	365	229	267	47	53	19	19	26	25
South	184	207	77	89	46	53	36	39	26	26
West	66	73	33	38	7	7	15	16	11	12
Total	1,374	1,551	909	1,042	207	236	130	142	127	131

SOURCE: Congressional Budget Office.

TABLE B-2. (Continued)

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast. For further detail, see: The Congressional Budget Office, The Outlook for Economic Recovery, February 1983.

a. This table includes only public housing authorities that receive operating subsidies through the PFS.

b. See Appendix A for a list of the states included in each HUD region.

c. Very large PHAs are those with 6,600 or more units. Large PHAs are those with 1,250 to 6,599 units. Medium PHAs are those with 500 to 1,249 units. Small PHAs are those with from 100 to 499 units.

TABLE B-3. PROJECTED SUBSIDY LEVELS UNDER CBO'S REESTIMATE OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT SYSTEM, 1984-1988 a/

	1984	1985	1986	1987	1988
	Average Funding Level (dollars per unit per month)				
Adjusted Fair Market Rent (FMR) b/	263	276	287	299	310
PHA Income c/	113	119	127	136	144
Federal Subsidy (FMR Less Income) d/	126	127	129	132	134
Subsidy for Operations e/	100	100	100	101	102
Subsidy for Improvements f/	26	27	29	31	32
	Total Funding Level (millions of dollars)				
Adjusted Fair Market Rent (FMR) b/	3,390	3,640	3,780	3,900	4,010
PHA Income c/	1,480	1,600	1,700	1,800	1,890
Total Federal Subsidy (FMR-Income) d/	1,630	1,670	1,690	1,710	1,730
Subsidy for Operations e/	1,290	1,310	1,310	1,310	1,310
Subsidy for Improvements f/	340	360	380	400	420
Subsidy for Other PHAs	50	50	60	60	60

SOURCE: Congressional Budget Office.

TABLE B-3. (Continued)

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast.

a. These estimates of the cost of the Administration's proposal vary from the Administration's estimates for several reasons. First, they exclude costs assumed to be funded outside the FMR system, such as payments to U.S. territories. Second, the Administration's estimates include the effects of proposals to count payments under the Food Stamp program as income in determining rent charges and to raise the maximum increase in rents from 10 percent to 20 percent a year. Other differences arise because of differences between the Administration's economic forecast and that of the Congressional Budget Office. Finally, use of different data bases produced minor differences in the results.

b. Adjusted FMR is the FMR in an area adjusted for the distribution of a PHA's units by number of bedrooms, the number of high-rise units, tenant-paid utilities, and debt service. See text for details.

c. Includes rent collections and interest income.

d. Note that the subsidy received is subject to floors and caps and is not, therefore, strictly equal to FMR minus PHA income. This excludes subsidies currently calculated outside the Performance Funding System for U.S. territories.

e. Total subsidy minus that portion assumed to be used for improvement needs, defined as 20 percent of nonutility allowable expense levels calculated under the PFS.

f. Defined as 20 percent of nonutility allowable expense levels calculated under the PFS.

TABLE B-4. PROJECTED OPERATING SUBSIDY LEVELS UNDER CBO REESTIMATE OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SYSTEM, BY REGION AND SIZE OF PUBLIC HOUSING AUTHORITY, 1984 AND 1988 a/

Region b/	Total		Size of Public Housing Authority c/							
			Very Large		Large		Medium		Small	
	1984	1988	1984	1988	1984	1988	1984	1988	1984	1988
			Average Subsidy (dollars per unit per month)							
Northeast	128	117	155	144	124	109	87	79	72	67
Central	88	100	143	161	76	92	40	44	35	40
South	70	80	118	142	85	96	49	54	37	40
West	76	90	125	140	79	98	73	85	32	41
Total	100	102	144	146	95	100	61	62	45	47
			Total Subsidy (millions of dollars)							
Northeast	726	664	512	478	100	90	57	49	57	47
Central	314	362	224	258	47	57	18	20	25	28
South	182	211	77	93	45	51	35	38	26	29
West	65	77	33	37	7	9	15	17	10	13
Total	1,288	1,313	845	865	199	206	125	124	119	117

SOURCE: Congressional Budget Office.

TABLE B-4. (Continued)

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast. For further detail, see: The Congressional Budget Office, The Outlook for Economic Recovery, February 1983.

a. Operating subsidies are defined as the total subsidy under the FMR proposal, minus the amount assumed to be needed for improvements. The Administration estimates improvement funding to be 20 percent of allowable expense levels calculated under the Performance Funding System. This table includes only public housing authorities that currently receive operating subsidies under the Performance Funding System.

b. See Appendix A for a list of the states included in each HUD region.

c. Very large PHAs are those with 6,600 or more units. Large PHAs are those with 1,250 to 6,599 units. Medium PHAs are those with 500 to 1,249 units. Small PHAs are those with from 100 to 499 units.

TABLE B-5. ESTIMATED CHANGE IN FUNDING FOR OPERATING SUBSIDIES FROM PERFORMANCE FUNDING SYSTEM (PFS) TO CBO'S REESTIMATE OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SYSTEM, NORTHEAST REGION, 1984-1988 (Percent distribution) a/

Change from PFS to FMR	1984	1985	1986	1987	1988
		Federal Operating Subsidies b/			
-50 Percent or More	--	2	4	7	8
-49 to -25	2	9	50	48	54
-24 to -10	48	62	19	19	16
-9 to -1	30	9	13	15	14
No Change	20	12	6	4	2
+1 to +10	c/	7	7	5	4
+11 to +25	c/	1	1	2	2
+26 to +50	c/	--	d/	1	1
+More than 50	c/	--	--	--	--

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast.

Dashes in table indicate that no units fell within that category.

a. These funding levels are weighted by the number of units managed by each public housing authority. The comparison includes only public housing authorities that currently receive operating subsidies under the Performance Funding System. See Appendix A for a list of the states included in the Northeast region.

b. Operating subsidies are total federal subsidies under the FMR alternative minus the amount assumed to be necessary for improvements, which is defined as 20 percent of nonutility allowable expense levels under each year's projected PFS funding.

c. The Administration's proposal is designed in such a way that no PHA could receive an operating subsidy in 1984 larger than it would have received even under the PFS.

d. Less than 0.5 percent.

TABLE B-6. ESTIMATED CHANGE IN FUNDING FOR OPERATING SUBSIDIES FROM PERFORMANCE FUNDING SYSTEM (PFS) TO CBO'S REESTIMATE OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SYSTEM, CENTRAL REGION, 1984-1988 (Percent distribution) a/

Change from PFS to FMR	1984	1985	1986	1987	1988
		Federal Operating Subsidies b/			
-50 Percent or More	--	--	--	--	--
-49 to -25	--	1	1	2	3
-24 to -10	2	6	8	8	8
-9 to -1	22	19	19	24	31
No Change	75	22	22	17	10
+1 to +10	c/	43	31	27	18
+11 to +25	c/	5	13	15	20
+26 to +50	c/	3	2	3	6
+More than 50	c/	1	3	4	5

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast.

Dashes in table indicate that no units fell within that category.

a. These funding levels are weighted by the number of units managed by each public housing authority. The comparison includes only public housing authorities that currently receive operating subsidies under the Performance Funding System. See Appendix A for a list of the states included in the Central region.

b. Operating subsidies are total federal subsidies under the FMR alternative minus the amount assumed to be necessary for improvements, which is defined as 20 percent of nonutility allowable expense levels under each year's projected PFS funding.

c. The Administration's proposal is designed in such a way that no PHA could receive an operating subsidy in 1984 larger than it would have received under the PFS.

TABLE B-7. ESTIMATED CHANGE IN FUNDING FOR OPERATING SUBSIDIES FROM PERFORMANCE FUNDING SYSTEM (PFS) TO CBO'S REESTIMATE OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SYSTEM, SOUTH REGION, 1984-1988 (Percent distribution) a/

Change from PFS to FMR	1984	1985	1986	1987	1988
		Federal Operating Subsidies b/			
-50 Percent or More	--	1	1	1	2
-49 to -25	1	2	2	2	3
-24 to -10	4	4	5	5	6
-9 to -1	7	8	17	31	29
No Change	89	32	20	8	5
+1 to +10	c/	44	26	20	19
+11 to +25	c/	7	24	25	20
+26 to +50	c/	1	2	6	11
+More than 50	c/	1	3	3	5

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast.

Dashes in table indicate that no units fell within that category.

a. These funding levels are weighted by the number of units managed by each public housing authority. The comparison includes only public housing authorities that currently receive operating subsidies under the Performance Funding System. See Appendix A for a list of the states included in the South region.

b. Operating subsidies are total federal subsidies under the FMR alternative minus the amount assumed to be necessary for improvements, which is defined as 20 percent of nonutility allowable expense levels under each year's projected PFS funding.

c. The Administration's proposal is designed in such a way that no PHA could receive an operating subsidy in 1984 larger than it would have received under the PFS.

TABLE B-8. ESTIMATED CHANGE IN FUNDING FOR OPERATING SUBSIDIES FROM PERFORMANCE FUNDING SYSTEM (PFS) TO CBO'S REESTIMATE OF THE ADMINISTRATION'S PROPOSED FAIR MARKET RENT (FMR) SYSTEM, WEST REGION, 1984-1988 (Percent distribution) a/

Change from PFS to FMR	1984	1985	1986	1987	1988
		Federal Operating Subsidies b/			
-50 Percent or More	--	--	--	--	--
-49 to -25	--	3	3	3	3
-24 to -10	3	--	--	--	--
-9 to -1	--	11	25	18	18
No Change	97	24	12	19	8
+1 to +10	c/	45	19	11	21
+11 to +25	c/	17	35	32	30
+26 to +50	c/	--	6	16	18
+More Than 50	c/	--	--	1	1

SOURCE: Congressional Budget Office.

NOTE: The effect of the rent increase ordered by the 1981 budget reconciliation act on PHA revenues is based on estimates by the Department of Housing and Urban Development. Other estimates are based on assumptions consistent with the Congressional Budget Office midwinter 1983 economic forecast.

Dashes in table indicate that no units fell within that category.

a. These funding levels are weighted by the number of units managed by each public housing authority. The comparison includes only public housing authorities that currently receive operating subsidies under the Performance Funding System. See Appendix A for a list of the states included in the West region.

b. Operating subsidies are total federal subsidies under the FMR alternative minus the amount assumed to be necessary for improvements, which is defined as 20 percent of nonutility allowable expense levels under each year's projected PFS funding.

c. The Administration's proposal is designed in such a way that no PHA could receive an operating subsidy in 1984 larger than it would have received under the PFS.

APPENDIX C. CURRENT LEGISLATIVE PROPOSALS TO MODIFY SUBSIDIES FOR PUBLIC HOUSING

The House and Senate Banking Committees have each reported housing authorization bills, H.R. 1 and S. 1338, that would change the manner in which subsidies for public housing are determined. 1/ The major provisions of the bills that relate to public housing are summarized here.

HOUSING AND URBAN-RURAL RECOVERY ACT OF 1983 (H.R. 1)

The major change that the Housing Banking Committee would make in the current system for subsidizing public housing would be to specify in law the manner in which operating subsidies are to be determined. The bill would set operating subsidies at $1.55 billion for 1984 and modernization funds at $2.1 billion. In addition, it would:

- Adopt a modified version of the Performance Funding System (PFS);
- Establish a demonstration program enabling public housing authorities to develop child care programs;
- Set standards for removing units from the stock of public housing; and
- Require the Secretary of Housing and Urban Development (HUD) to make annual reports to the Congress.

The Performance Funding System

H.R. 1 would adopt the PFS as in effect on March 1, 1983 (see part 890 of Title 24 of the Code of Federal Regulations) with modifications of allowable expense levels (AELs), the treatment of utilities, and the

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1. The version of S. 1338 described here is the one offered by the Senate Banking Committee as a substitute to the Committee-passed bill and accepted by the Senate on June 21, 1983.

calculation of revenues. In addition, the bill calls for a pro rata reduction in operating subsidies each year if the amount appropriated is less than the amount determined to be necessary by the PFS.

Allowable Expense Levels. Both the base AELs and the way in which annual adjustments are made would be modified. (See Chapter IV for a description of current practice.) The bill directs that the AELs of public housing agencies in distressed areas be adjusted to reflect the higher costs of operating in such an environment. The adjustment is to be made on the basis of the local area's growth lag, poverty, age of housing--factors used to determine funding levels in the Community Development Block Grant program--and other characteristics deemed appropriate by the Secretary of HUD. In addition, HUD is to establish a review process to raise AELs that are underestimated, either because the base year was not representative, or because circumstances have changed subsequently.

The annual adjustments to AELs would also be modified by H.R. 1. The adjustment for changes in the housing stock would be simplified by raising each PHA's AEL by one-half of one percentage point, with other adjustments as necessary to account for significant changes in the number or type of units managed by a PHA. A year-end retrospective adjustment for inflation would also be made, if the actual inflation was more or less than the amount projected when subsidies were determined.

Utilities. H.R. 1 would also modify the treatment of utility costs under the PFS. First, it would extend the base period for consumption from three years to four years in 1984 and five years thereafter. Second, PHAs would receive 75 percent of the savings that result from decreases in consumption relative to the base period, instead of 50 percent as is currently the rule, to be used to finance improvements to their public housing stock. They would continue to pay 50 percent of the additional cost of rising consumption, however.

Finally, the bill would allow a PHA to include in its AEL those expenses associated with appealing utility rates that are not otherwise reimbursed. The amounts that are recovered through litigation would, however, be deducted from allowable expense levels up to the amount spent by the PHA on its appeal. Of any amounts recovered in excess of a PHA's costs, the PHA would be allowed to retain 75 percent.

Revenues. H.R. 1 would also modify the manner in which PHA revenues would be calculated. First, any income received through other federal programs, from state or local governments, or from private sources would not be counted as income in calculating a PHA's subsidy.

Second, it would require HUD to count in determining subsidies only 50 percent of the increased revenues that result from increasing occupancy rates. Thus, if a PHA had an occupancy rate of 80 percent and increased it to 90 percent, HUD would, in determining future subsidies, assume that the PHA had an 85 percent occupancy rate. H.R. 1 does not specify, however, how long this treatment would continue or how further increases or declines in future years would be calculated.

Child Care Demonstration Program

H.R. 1 would establish a $3 million demonstration program for PHAs to develop child care programs in public housing projects. Funds would be distributed to PHAs that do not already provide such services, to be used for operating expenses and for minor repairs to the facilities to be used. PHAs would be expected to serve, in part, single-parent households to enable them to seek or train for employment and to employ, where possible, elderly tenants of public housing projects.

Removal of Units from the Public Housing Stock

H.R. 1 would also specify the process for removing units from the public housing stock by demolition, sale, or disposal. The rules would include requirements that:

- The PHA and the unit of local government must certify their approval;
- The project must be substantially unoccupied;
- The cost of rehabilitation must be higher than the cost of replacement;
- Tenants and tenant councils must be notified;
- HUD and the PHA must have arranged relocation assistance for tenants affected; and
- The PHA must secure funding commitments from HUD to replace units with equal numbers of newly constructed or rehabilitated ones, generally in the same neighborhood.

The rules could be waived if sound social and economic conditions for the removal of units existed, and if a majority of the tenants affected agreed.

Reporting Requirements

H.R. 1 would also require a series of annual reports as well as a special report. Each January, HUD would be required to report to the Congress on the amount of assistance estimated to be needed for the coming year, and to present any proposal it wished to make for modifying the funding mechanism. In addition, the bill would require a separate report, due in March 1984, considering and recommending ways to increase incentives for PHAs to reduce long-term costs and to increase management efficiency.

HOUSING AND COMMUNITY ACT OF 1983 (S. 1338)

The Senate Banking Committee bill, S. 1338, would modify the current subsidy system for public housing more extensively than would H.R. 1. S. 1338 would continue a performance funding system for setting operating subsidies, would require some modifications to the current system, and would establish a commission to assist the Secretary of HUD in setting management standards for public housing and other related matters. In addition, it would modify the way in which modernization and major improvements in the public housing stock were made, and the provisions for the demolition or disposition of public housing units. Operating subsidies would be set at $1.5 billion and modernization funds at $1.6 billion.

The Performance Funding System

Unlike H.R. 1, which would legislate the provisions of the PFS, S. 1338 would establish the general characteristics of the mechanism for setting operating subsidies but leave its implementation to the Secretary of HUD. Subsidies would be based on standards that reflect the operation of a well-managed project, taking into account the character and location of the project and the characteristics of families served. The bill would require that the system in effect at the start of any year not be changed during that year. In addition, it would:

- Require regular adjustments to reflect changes in the cost of operating the prototype project;
- Require annual adjustments for the difference between expected and actual rates of inflation;
- Require PHAs to share equally with HUD any differences between projected and actual utility rates, as well as differences in consumption;

- Count only tenants' rent payments and interest earned on such payments in setting subsidy levels, thus not reducing subsidies if PHAs receive income from other sources;

- Eliminate subsidies for vacant units in excess of 2 percent in 1984, in excess of 1 percent in 1985, and for all vacancies beginning in 1986; and

- Require a pro rata distribution of funds in the event that appropriated levels are less than estimated to be required for the PFS.

Management of Public Housing

S. 1338 would establish a Public Housing Performance Standards Advisory Commission to assist the Secretary of HUD in designing and applying standards for public housing management. The 13-member commission would be appointed by the Secretary on the basis of nominations by tenants, public housing managers, and local government associations. The Commission would develop and recommend standards for the efficient and professional management of public housing and also Section 8 housing assistance. It would also develop and recommend procedures for evaluating public housing authorities on the basis of these standards. In addition, the Commission would be asked to consider other issues, including ways to improve maintenance of the public housing stock, and education and training programs for public housing managers.

Modernization

S. 1338 would phase out the Comprehensive Improvement Assistance Program (CIAP) beginning in 1985 and would provide instead formula-based subsidies, to be augmented by a discretionary grant program operated by the Secretary of HUD.

Modernization funding in 1984 would be used to bring as many usable units as possible to habitability standards. CIAP would be available after that time only for public housing agencies with units that fail to meet physical quality standards. The standards to be used in making these judgments are not detailed in the bill.

Beginning in 1985, S. 1338 would replace CIAP with a formula-based, annual subsidy equal to 15 percent of nonutility operating expenses. In addition, the Secretary of HUD would be directed to establish a major systems replacement fund, to be used for major repairs, replacement of building systems, or major management system improvements. The specific activities to be financed through this fund would be determined by the Secretary in consultation with the Commission.

Demolition and Disposition of Public Housing Units

S. 1338 would set standards governing the removal of units from the public housing stock. Public housing authorities proposing the removal of units from the stock would be required to develop their proposals in consultation with affected tenants and with local government officials and to arrange suitable housing accommodations for tenants who would be displaced by the agency's proposals.

The Secretary of HUD would be required to approve all proposals to remove units from the public housing stock. Proposals to demolish projects could be approved if the project was obsolete and if modifications returning it to useful life were not feasible. Parts of projects could be demolished if obsolete and if the loss of units would help ensure the viability of remaining units. Proposals to dispose of units, by sale or other means, could be approved if the area surrounding the project was adversely affecting the health and safety of tenants or the operation of the project; or if the disposition of the project would allow the acquisition or rehabilitation of other projects that would more efficiently serve low-income households; or if other factors made the disposition in the best interest of tenants. Proceeds from the disposition of units would be required to be used for payment of the outstanding obligations associated with the project and, if sufficiently large, for the provision of additional housing assistance to low-income families.